TABLE OF CONTENTS

BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission
DOCKETED

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COMMISSIONERS

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN K. MAYES

IN THE MATTER OF THE APPLICATION OF ARIZONA WATER COMPANY, AN ARIZONA CORPORATION, FOR ADJUSTMENTS TO ITS RATES AND CHARGES FOR UTILITY SERVICE FURNISHED BY ITS WESTERN GROUP AND FOR CERTAIN RELATED APPROVALS.	DOCKET NO. W-01445A-04-0650 DECISION NO. 68302 **OPINION AND ORDER**

DATES OF HEARING:	October 15, 2004 (Oral Argument), June 10 and 16, 2005 (Pre-Hearing Conferences), June 17, 20, 21, 22, 23 and 24, 2005
PLACE OF HEARING:	Phoenix, Arizona
ADMINISTRATIVE LAW JUDGE:	Teena Wolfe
IN ATTENDANCE:	Kristen K. Mayes, Commissioner
APPEARANCES:	Norman D. James and Jay L. Shapiro, FENNEMORE CRAIG, and Robert W. Geake, Vice President and General Counsel, on behalf of Arizona Water Company; Marvin S. Cohen, SACKS TIERNEY, on behalf of Pivotal Group, Inc.; Joan S. Burke and Danielle D. Janitch, OSBORN MALEDON, on behalf of the City of Casa Grande; Daniel Pozefsky, on behalf of the Residential Utility Consumer Office; and Timothy J. Sabo and Diane M. Targovnik, Attorneys, Legal Division, on behalf of the Utilities Division of the Arizona Corporation Commission.

BY THE COMMISSION:

I. INTRODUCTION

On September 8, 2004, Arizona Water Company ("Arizona Water," "Company," or "Applicant") filed the above-captioned application with the Arizona Corporation Commission ("Commission") requesting a rate increase for the Company's Western Group systems. Arizona

Water operates a total of 18 water systems located in eight Arizona counties serving approximately 72,000 customers. The rate application filed in this docket involves only the Company's Western Group, which served 20,266 customers at December 31, 2003, the end of the test year. Pursuant to Decision No. 58120 (December 23, 1992), the Company's Western Group includes five of Arizona Water's systems: Casa Grande, Coolidge, White Tank, Ajo Heights, and Stanfield. At the end of the test year, the Casa Grande system served 14,981 customers; Coolidge, 3,049 customers, White Tank, 1,337 customers; Ajo Heights, 681 customers; and Stanfield, 218 customers. The Company recently received rate increases for its Eastern Group systems in Decision No. 66849 (March 19, 2004) ("Eastern Group Decision"), and for its Northern Group systems in Decision No. 64282 (December 28, 2001) ("Northern Group Decision").

The current rates and charges for the Western Group systems, authorized in Decision No. 58120, were based on a test year ended December 31, 1990, and became effective on January 1, 1990. The service charges were later modified in Decision No. 60512 (December 3, 1997). The Company's purchased power adjustor mechanisms were changed in Decision No. 58293 (May 19, 1993) and Decision No. 62755 (July 25, 2000). The Company's Monitoring Assistance Program ("MAP") surcharge was established in Decision No. 62141 (December 14, 1999).

A. Procedural History

Following the Company's filing of the application on September 8, 2004, on September 24, 2004, the Commission's Utilities Division Staff ("Staff") filed a Motion to Require Supplemental Sufficiency Information, or in the Alternative, to Suspend the Rate Case Timeclock. The Motion requested that the Company be required to submit an inverted tier rate design as a condition of sufficiency under the rate case time-clock rule, or in the alternative, that the rate case time-clock be extended until such time that the Company filed an inverted block rate design. The Motion requested Oral Argument and expedited consideration. On October 1, 2004, Arizona Water filed a Response

opposing Staff's Motion. On October 8, 2004, Staff filed a Reply to the Company's Response. Also on October 8, 2004, Staff filed a letter informing the Company that its application had not met the sufficiency requirements outlined in A.A.C. R14-2-103 because it did not contain the inverted tier rate design requested by Staff. On October 12, 2004, the Residential Utility Consumer Office ("RUCO") filed a Notice of Lodging RUCO's Response to the Motion pending a ruling on its intervention request.

On October 15, 2004, Oral Argument was held on Staff's Motion as scheduled. RUCO was granted intervention during the proceeding. After consideration of Staff's Motion, Arizona Water's Response, Staff's Reply, RUCO's Response, and the arguments of Staff, RUCO and Arizona Water on the issues raised in the Motion, the Motion was denied on the grounds that the Company had already provided its proposed rate design in its application. The Company was ordered to timely respond to any data requests posed by the parties. The parties were also informed that the Company was free to submit an alternative rate design in its rebuttal testimony for consideration and review prior to the hearing on the application.

On October 18, 2004, Staff filed a letter notifying Arizona Water that its application met the sufficiency requirements set forth in A.A.C. R14-2-103, and classifying Arizona Water as a Class A utility. On November 18, 2004, a Rate Case Procedural Order was issued setting a hearing date and setting procedural deadlines for public notice, intervention, discovery, and for prefiling direct, rebuttal, surrebuttal and rejoinder testimony.

On March 2, 2005, Arizona Water filed a Certificate of Notice certifying that the Company caused a copy of the form of public notice as required by the November 18, 2004 Procedural Order to be published in the *Coolidge Examiner* and *Casa Grande Dispatch* on January 26, 2005, and that the Company mailed a copy of the form of public notice to each of its customers beginning with the first billing cycle in February, 2005, with the mailing completed on February 28, 2005. Public comment

letters in opposition to the Company's proposed rate increase were filed on January 21, February 11, February 28, March 3, June 15, and July 29, 2005.

Intervention was granted to RUCO on October 15, 2004, to Pivotal Group, Inc. ("Pivotal") on February 15, 2005, and to the City of Casa Grande ("Casa Grande" or "City") on April 1, 2005.

On May 19, 2005, Staff filed a Notice of Settlement Negotiation indicating that Staff would be entering into settlement negotiations with the Company limited to the subject of how to deal with the Company's past, present and future costs associated with its Central Arizona Project ("CAP") water allocations. No settlement agreement was filed.

A hearing was held commencing on June 17, 2005 and continuing on June 20, June 21, June 22, June 23, and June 24, 2005. On June 16, 2005, the date noticed to the public and Arizona Water's Western Group customers as the date the hearing would commence, the record was opened for the purpose of taking comment from members of the public. No members of the public appeared to provide comment on the application, either on June 16, 2005 or on any subsequent days of the hearing.

The Company, Casa Grande, RUCO and Staff appeared and presented evidence at the hearing. Pivotal also appeared at the hearing. Arizona Water, Casa Grande, RUCO and Staff filed closing briefs on August 1, 2005, and reply briefs on August 22, 2005. Following the filing of closing briefs, the matter was taken under advisement pending the submission of a Recommended Opinion and Order to the Commission.

B. Rate Application

The application is based on a test year ended December 31, 2003. The Company is requesting an increase in revenues for the Western Group of $1,464,966, or 13.72 percent, over test year adjusted revenues of $10,675,355, for a total revenue requirement of $12,140,321. RUCO is recommending an increase in revenues of $110,229, or 1.10 percent, over test year adjusted revenues

of $10,003,254, for a total revenue requirement of $10,113,483. Staff is recommending a revenue increase of $74,152, or .07 percent over test year adjusted revenues of $10,675,355, for a total revenue requirement of $10,749,507. Based on adjustments to the Company's filing as set forth herein, we authorize an increase in revenues of $160,510, an increase of 1.50 percent over test year adjusted revenues of $10,675,355, for a total revenue requirement of $10,835,865.

II. RATE BASE

A. Deferred CAP M&I Capital Charges

1. Background

Arizona Water has four subcontracts with the Central Arizona Water Conservation District ("CAWCD") for delivery of CAP water for municipal and industrial ("M&I") use (Garfield Rb. at 6). Three of the Company's CAWCD subcontracts are for delivery of its CAP allocations for the Company's Western Group systems of Casa Grande, 8,884 acre-feet; Coolidge, 2,000 acre-feet; and White Tank, 968 acre-feet; on an annual basis (*id.*).[1] Under the subcontracts, the Company is required to make two different types of payments for water delivery services: first, whether Arizona Water actually takes delivery of CAP water or not, it must pay, in equal semi-annual installments, a CAP M&I capital charge based on each system's total allotment multiplied by an amount per acre-foot established by the CAWCD; and second, Arizona Water must pay, based on actual CAP deliveries and estimated expenses for the upcoming year, an annual CAP operation, maintenance, and replacement ("OM&R") expense payment in equal monthly installments (Garfield Rb. at 6-7). The purpose of the CAP M&I capital charge is to repay the CAP construction costs to the United States (*id.* at 7). Arizona Water asserts that by making annual CAP M&I payments and thereby retaining the right to use CAP water, which is an alternative, renewable water source, that it has acted

[1] Deferred CAP M&I capital charges associated with Arizona Water's CAWCD subcontract for delivery of its used and useful CAP allocation for its Apache Junction system are currently being recovered on an amortized basis per the recent Eastern Group Decision. A portion of the Company's Apache Junction CAP allocation is provided to golf courses as non-potable water.

consistent with State water policy, in addition to ensuring the availability of water for its customers on a long-term basis (Garfield Rb. at 8).

CAP water is surface water and therefore requires treatment for potable use in compliance with the United States Environmental Protection Agency ("EPA") and Arizona Department of Environmental Quality ("ADEQ") surface water treatment requirements.

2. Current Usage of CAP Allocations

During the test year, the Company delivered 2,279 acre feet of Arizona Water's CAP allocation for the Casa Grande system to commercial and industrial customers for non-potable uses under the Company's non-potable tariff (Hubbard Rb. at 15, 16). In return for the Company's commitment to deliver up to 2,000 acre-feet of untreated CAP water annually to the Desert Basin power plant, Arizona Water's Casa Grande system is reimbursed annually for a portion of its deferred CAP M&I capital charges (Garfield Rj. at 9; Hubbard Rj. at 5). In the absence of a contract requiring a customer to commit to a portion of Arizona Water's CAP allocation, non-potable water customers are not liable for deferred CAP M&I charges, and the CAP allocation remains available to other customers (Hubbard Rj. at 5). The Company proposes that the $142,896 portion of the Casa Grande system deferred CAP M&I charges related to the delivery of a total of 279 acre-feet of CAP water to two golf courses during the test year be placed in rate base, amortized over 10 years (Hearing Exh. A-28; Tr. at 802).[2] RUCO does not oppose the Company's requested treatment of the portion of the CAP allocation that customers are receiving and paying for (RUCO Br. at 9), and no party alleges that this portion of the Company's Casa Grande system CAP allocation was not used and useful during the test year. We agree with the Company that serving untreated CAP water to customers who do not require potable water to meet their water needs is a valid use of its CAP allocation, and that the 279 acre feet of the Company's CAP allocation delivered to the two Casa Grande system golf

[2] The total amount of the deferred CAP M&I capital charges for the Casa Grande system at December 31, 2003 was $3,525,803 (Hubbard Rj. Sched. SLH-RJ4 at 8, line 15).

course commercial and industrial customers as non-potable water during the test year was used and useful. Therefore $142,896 in the associated Casa Grande system CAP M&I capital charges will be accorded rate base treatment in this proceeding, on an amortized basis consistent with the amortization period for the CAP Hook-Up Fee discussed below.

3. Planned CAP Treatment Facilities

a. Casa Grande and Coolidge

Arizona Water states that it has made financial commitments toward design and construction of a CAP water treatment plant with an initial capacity of 10 million gallons per day ("gpd") that will treat both its Casa Grande and Coolidge CAP allocations (Whitehead Rb. at 3), which the Company projects will all be needed to offset growing demand for water in the Casa Grande and Coolidge area (Garfield Rb. at 11). The Company's witness testified that the planned treatment plant will also have the potential to treat CAP water supplies for other water providers holding CAP allocations, such as the City of Eloy and the City of Florence, and that water treated at the planned plant has the potential of ultimately serving Casa Grande, Coolidge, Arizona City, Tierra Grande, Stanfield, and other areas within Arizona Water's certificated areas (Whitehead Rb. at 5). The Company has purchased approximately 68 acres of land southeast of Coolidge about one-half mile west of the CAP canal, and has submitted an application to the Arizona State Land Department for right-of-way access to cross state land from the CAP canal to the planned regional CAP plant site (Whitehead Rb. at 4). The Company plans to construct a 48-inch pipeline to deliver water from the CAP canal to the planned treatment facility, and has completed the initial design of the booster pump station necessary to pump water from the canal and pressurize the pipeline (*id.*). The Company plans to submit the plans for the CAP treatment plant to the CAWCD later this year for review and comment (Whitehead Rb. at 4). Arizona Water's witness testified that the Company plans to bid the treatment plant design in 2007; award a design contract in 2008; bid for the construction of the first phase commencing in 2009;

commence construction in 2009; and complete the project in 2012 (Whitehead Rb. at 9-11).

b. White Tank

Arizona Water has been working with Arizona-American Water Company's Agua Fria Division on an agreement that would provide for the treatment of Arizona Water's White Tank CAP allocation at a regional water treatment plant planned to be completed in 2008 (Hubbard Rb. at 16), located along the Beardsley Canal (Garfield Rb. at 13). Arizona Water's witness stated that upon completion of the planned treatment plant, its entire White Tank allocation will be used to serve its customers (*id.*).

4. Application's Request Regarding Deferred CAP M&I Charges

The Company's calculation of adjusted test year net operating income in its application includes CAP M&I charges reflected as a pro forma adjustment to purchased water expense, and the amortization of deferred CAP M&I capital charges reflected as a pro forma adjustment to test year depreciation and amortization expense (Hubbard Rb. at 15). The application also requests authorization to amortize the deferred CAP M&I capital charges accumulated as of the end of the test year over a ten-year period, as follows: $3,525,803 for the Casa Grande system, which is net of $989,314 from non-potable test year sales; $1,046,011 for the Coolidge system; and $506,268 for the White Tank system, for a combined balance of $5,078,082 (*id.* at 15-16).

No other party agreed with Arizona Water's application position to place deferred CAP M&I charges for CAP water that is not currently being used in rate base.

5. Alternative Deferred CAP M&I Charges Recovery Proposals

On May 19, 2005, Staff filed a Notice of Settlement Negotiation indicating that Staff would be entering into settlement negotiations with the Company limited to the subject of how to deal with the Company's past, present and future costs associated with its CAP water allotments. No settlement agreement was filed prior to the hearing. However, both the Company and Staff proposed

alternatives to Arizona Water's request as set forth in its application. In rejoinder testimony filed on June 10, 2005, the Company proposed a hook-up fee to recover the deferred CAP M&I charges (Hubbard Rj. at 4-6, Exhibit SLH-RJ5). The rejoinder testimony proposed recovery of the deferred charges over a 10-year period by means of hook-up fees collected from new customers for a period of ten years in the amount of $289 for both the Casa Grande and Coolidge systems, and in the amount of $674 for the White Tank system (*id.*). Under Arizona Water's "rejoinder proposal," the hook-up fees would be collected on new lots in each system, and would be treated as non-operating revenue used both to pay ongoing CAP M&I charges and also to reduce the balance of deferred CAP M&I charges, which for accounting purposes would be treated as allowance for funds used during construction ("AFUDC") (Tr. at 821-822). The Company's rejoinder proposal also shows ongoing M&I charges to the Desert Basin power plant contract, discussed above, as being applied to reduce the M&I charges balance (*id.*).

Prior to the hearing, Staff filed its proposal for an alternative hook-up fee to recover the deferred CAP M&I charges over a 20 year period, with hook-up fees of $220 for the Casa Grande system, $150 for the Coolidge system, and $500 for the White Tank system (Olea Suppl. Scheds. SMO-1, SMO-2 and SMO-3).[3] At the hearing, Staff presented more detailed schedules showing its recommended hook-up fee recovery methodology. Staff's proposed methodology uses the same projections the Company used in its rejoinder proposal for customer growth, annual CAP M&I ongoing charges, AFUDC estimates based on the 2004 M&I rate, and ongoing M&I charges paid under the Desert Basin power plant contract, but with a 20 year amortization period (Hrg. Exh. S-33). Staff's proposal also includes a set of "Conditions for Approval of CAP Hook-Up Fee," and proposes requirements for a CAP Water Use Plan, the filing and Commission approval of which is one of Staff's recommended conditions for the collection of the CAP Hook-Up Fee (Olea Suppl. Sched.

[3] These hook-up fee amounts are proposed for meter sizes 1-inch and smaller. Larger hook-up fees are proposed for larger meter sizes (Olea Suppl. Scheds. SMO-1, SMO-2 and SMO-3).

SMO-4 and Attachment A).

Casa Grande opposes Arizona Water's recovery of deferred CAP M&I capital charges until Arizona Water prepares a water resource master plan ("WRMP") while giving Casa Grande the opportunity to participate in all stages of the WRMP process, including decisions relating to what the WRMP will include (City Reply Br. at 30).

6. Staff's Proposed Conditions for Approval of CAP Hook-Up Fee and Proposed Requirements for a CAP Water Use Plan

Staff states that the Company's plans to use its Casa Grande, Coolidge and White Tank CAP allocations sufficiently demonstrate a commitment to use its CAP allocations to allow the Company to begin to recover its prudently incurred CAP M&I capital charges, both deferred and ongoing, under the terms of Staff's proposed CAP Hook-Up Fee tariffs, but subject to Staff's proposed conditions (Olea Suppl. at 5-6). The conditions Staff proposes are reproduced here:

Schedule SMO-4

CONDITIONS FOR APPROVAL OF CAP HOOK-UP FEE

1) Arizona Water Company ("AWC") must submit by December 31, 2006, or six months prior to submission of its next rate case application, whichever comes first, a detailed Central Arizona Project Water Use Plan ("CAPWUP") for its Western Group water systems.

2) AWC must make best faith efforts to include the cities of Casa Grande and Coolidge in the development of the CAPWUP.

3) The CAPWUP must address all the issues outlined in Attachment A.

4) The CAPWUP must be approved by Staff prior to AWC's next rate case application being declared sufficient under A.A.C. R14-2-103.

5) The CAPWUP shall be approved, disapproved, or modified in AWC's next rate case by the Commission. If the CAPWUP is disapproved, the CAP Hook-up Fee shall be terminated and AWC shall refund all CAP Hook-up Fee monies collected to that point along with six percent (6%) interest. The refund method shall be determined by the Commission.

6) The approval by Staff or the Commission of the CAPWUP shall mean only that the CAPWUP has adequately addressed all the issues outlined in

Attachment A. CAPWUP approval by Staff or the Commission shall **not** be interpreted as a used and useful determination nor as pre-approval of reimbursement of any future expenditures in completing the plan.

7) In AWC's next rate case the Commission shall reevaluate this CAP Hook-up Fee to determine if it should be continued, eliminated or modified based on the CAPWUP and any other evidence that may be introduced by parties to that case.

8) If in AWC's next rate case the Commission orders continuation of the CAP Hook-up Fee or any other recovery mechanism designed to recover CAP deferrals, the Commission Staff shall audit the CAP deferral accounts of AWC's systems holding CAP allocations and shall make any necessary adjustments, true-ups, and re-calculations to determine the proper values to carry forward.

9) Staff will utilize AWC's annual cost of debt to determine the rate for allowance of funds used during construction ("AFUDC") included in the CAP deferrals.

Attachment A

CENTRAL ARIZONA PROJECT WATER USE PLAN ("CAPWUP")

The plan should address the following:

1) Existing water supplies and demand patterns for the last two years (such information as required on the Water Use Data Sheet).

2) Future water supplies and demand patterns demonstrating how and when CAP water will be used through the year 2025. All future water sources that the Company plans to use* other than CAP should be discussed. All assumptions used to make projections should be clearly explained.

3) All major infrastructure components required to use CAP water through the year 2025 should be listed and described in as much detail as possible. These would include such items as, but not be limited to, treatment plants, transmission mains, storage tanks, pumping stations, etc.

4) Projected capital and Operation and Maintenance costs for all future water supplies (including CAP water) through the year 2025 should be listed in as much detail as possible. All assumptions used to make these projections should be clearly explained.

5) How CAP water will be used to address the arsenic issue (if it will be).

* Staff added the underlined language at the hearing.

7. Casa Grande's Proposed Conditions for Approval of CAP Hook-Up Fee and Proposed Requirements for a Water Resource Master Plan

Casa Grande proposes that Arizona Water's recovery of CAP M&I capital charges be linked to Arizona Water's willingness to work with Casa Grande in designing and preparing a water WRMP (City Br. at 5). The City opposes Arizona Water's recovery of CAP M&I capital charges until a WRMP is prepared, and it expects "real-time" input into preparation of the WRMP (City Reply Br. at 2). Casa Grande asserts that the detail in its WRMP is necessary to implement the CAP Water Use Plan proposed by Staff (*id.*), and that "[r]eal time input by the City during the design and preparation of the WRMP (or the CAPWUP) can occur without interference with the Company's business decisions." (City Reply Br. at 7). Casa Grande submitted as an Exhibit at the hearing a draft outline of the plan (Hrg. Exh. CCG-7), which is reproduced here:

DRAFT OUTLINE
CASA GRANDE WATER RESOURCE MASTER PLAN

I Existing water supplies and demand patterns
- A. Current water supplies
  1. Number of wells, location, annual volume of production over past five years
  2. Condition of wells, maximum annual production potential, required capital improvements schedule
  3. Water quality profile and issues, i.e. arsenic
- B. Current water demands
  1. Annual sales by customer type and by meter size over past five years
  2. Seasonality and peak use, monthly demand patterns over past five years, peak day use
  3. Losses and unaccounted for water

II Future demands and net requirements
- A. Demographic/economic projections
  1. Population and employment growth trends, 1990 through 2005
  2. Published or available projections, developer plans
  3. Selection of high and low scenarios through at least 2025
- B. Water demand projections
  1. Selection of water demand forecasting approach, i.e. gallons per capita per day
  2. High and low water demand projection scenarios through at least 2025

C. Net Water Requirements—Comparison of water demand projections with available maximum supplies from existing wells, identification of future unmet needs over time

III Additional Groundwater Resources
- A. What is potential for acquiring groundwater rights, developing new wells
- B. Increased production volume potential over time
- C. Infrastructure requirements
- D. Capital, operating costs schedule
- E. Constraints and opportunities

IV CAP Water
- A. Available water volumes, schedule of availability
- B. Infrastructure requirements by component, location
- C. Capital, operating costs schedules
- D. Constraints and opportunities

V Non-potable water (effluent)
- A. Available water volumes, schedule of availability
- B. Infrastructure requirements, location
- C. Capital, operating costs schedules
- D. Constraints and opportunities

VI Other alternative resources-i.e. water purchases or transfers, etc.
- A. Available water volumes, schedule of availability
- B. Infrastructure requirements, location
- C. Capital, operating costs schedules
- D. Constraints and opportunities

VII Arsenic treatment
- A. Current plan
- B. Infrastructure requirements, location
- C. Capital, operating costs schedules
- D. Constraints and opportunities—potential integration with other water supply alternatives, i.e. blending, combined treatment, etc.

VIII Recommended water master plan
- A. Alternative supply scenarios or combination of resources considered
- B. Description of selected future supply plan
  1. Volume of new water available over time
  2. Infrastructure needs and location
- C. Justification of future supply plan
- D. Schedule for permitting, implementation
- E. Capital cost requirements schedule through 2025
- F. Operating cost requirements through 2025

8. Discussion

The Company is largely in agreement with the CAP Hook-Up Fee mechanism proposed by Staff for recovery of the Company's deferred M&I capital charges, and with some exceptions, discussed further below, agrees with the related conditions and the CAP Water Use Plan requirements proposed by Staff.

Arizona Water is opposed to having recovery of its deferred CAP M&I capital charges tied to Casa Grande's Proposed WRMP (Co. Br. at 6-13). The Company asserts that the City's request is extraordinary and unprecedented in that it asks the Commission to force the Company to cede control of fundamental management decisions to a municipality that in the past has tried to condemn its water system and has threatened to do so again (Co. Br. at 6). Arizona Water believes that granting the City's request would violate its right as a public utility to determine the type and extent of service to the public in the exercise of its managerial functions within the limits of adequacy and reasonableness (*id.*, citing *Southern Pacific Co. v. Ariz. Corp. Comm'n*, 98 Ariz. 339, 343, 404 P.2d 692, 694-95). The Company points out that the City's witness presented no testimony or evidence that Arizona Water has not adequately planned for water resources or that it has been unable to meet water demands by new customers (Co. Br. at 9). The Company attached an affidavit of William M. Garfield to its Reply Brief as Exhibit B. The Company prepared the affidavit to respond to a copy of a July 21, 2005 newspaper article that the City attached as Exhibit 2 to its Closing Brief. In a footnote, the City "asks the Commission to take judicial notice of the news article," claiming that it is "directly relevant to the need for water resource planning by Arizona Water Company" (City Br. at 8, fn. 2). The Company argues that the statements appearing in the article are not subject to judicial notice (Co. Reply Br. at 9-10), but in a footnote of its own, explains that it has attached the affidavit from Mr. Garfield "containing a detailed discussion of the events referenced in the article and explaining why the City's reliance on the article is misplaced" (Co. Br. at 10, fn. 8).

Arizona Water also points out that pursuant to new legislation passed earlier this year, the Casa Grande system must submit a water plan to the Arizona Director of the Department of Water Resources ("ADWR") by January 1, 2007 for review and approval that must generally "evaluate the water supply needs in the service area and propose a strategy to meet identified needs" A.R.S. § 45-331(H). Arizona Water attached a copy of the new legislation as Exhibit A to its Reply Brief. Arizona Water believes that this new statutory requirement, combined with the CAP Water Use Plan recommended by Staff, should eliminate any concerns that the City may have regarding water resources planning (Reply Br. at 8).

RUCO supports the proposal made by Staff to address the CAP issue in this case (RUCO Br. at 10) and believes that Staff's conditions for approval of its proposed CAP Hook-Up Fees provide adequate safeguards to ensure that the objectives are met (RUCO Reply Br. at 3-4). RUCO's support of Staff's proposal is contingent upon inclusion of Staff's fifth proposed condition, which provides for a refund of all collected CAP Hook-Up Fees if the Company's CAP Water Use Plan is disapproved (*id.* at 4). RUCO asserts that this condition cannot harm the Company if it intends to act in good faith and present a reasonable CAP Water Use Plan (*id.)*.

9. Conclusion

It is not appropriate to put Arizona Water's deferred or ongoing CAP M&I charges for CAP water that is not currently being used in rate base, as proposed in the Company's application. The amortization of the deferred CAP M&I charges requested in the application will therefore not be adopted.

We do not believe that it is necessary or reasonable to adopt Casa Grande's recommendation to make any CAP M&I capital expense recovery contingent upon Arizona Water's submission of Casa Grande's proposed WRMP (*see* City Reply Br. at 30). Staff's witness testified that the WRMP proposed by Casa Grande goes into more detail than Staff would need to determine whether the

Company can begin recovering its deferred CAP costs (*see* Tr. at 1201-1203). We therefore disagree with Casa Grande's assertion that development of its WRMP is necessary to implement the CAP Water Use Plan proposed by Staff. While we would not discourage Arizona Water from engaging in a planning process similar to that outlined in Casa Grande's draft WRMP, we agree with Staff that through the planning the Company's witnesses described in rebuttal testimony, the Company has demonstrated a concrete enough commitment to using its CAP allocations to allow commencement of recovery of its deferred CAP M&I capital charges at this point in time through the methodology recommended by Staff, subject to the strict conditions supported by both Staff and RUCO, which include development of a CAP Water Use Plan as outlined above.

Neither do we believe that it is necessary or reasonable to adopt Casa Grande's recommendation to require that Casa Grande be allowed to participate in Arizona Water's decisions relating to what the WRMP (or the CAP Water Use Plan) will include (*see* City Reply Br. at 30). Staff's witness testified that by its proposed second condition for recovery of a CAP Hook-Up Fee, which requires AWC to make best faith efforts to include the cities of Casa Grande and Coolidge in the development of the CAP Water Use Plan, Staff intends for Arizona Water to keep the cities informed and make sure the cities are involved so that the cities aren't caught off guard by something the Company is going to do with regard to the water system (Tr. at 1192). We agree with Staff's stated intent. We also agree with the Company that management decisions regarding the use of its CAP water allocation are its own. We do not intend our adoption of Staff's proposed second condition number 2 requiring Arizona Water to make best faith efforts to include the cities as giving the cities a managerial or decision-making role in the development of the CAP Water Use Plan. Given the contentious litigation history between the Company and Casa Grande, we do not adopt this recommended condition lightly. We adopt it because we believe that the cities' "best faith" input will be valuable to the Company in its planning process. We fully recognize that it is ultimately Arizona

Water that will have the burden of demonstrating the prudence of its business decisions, and not the cities. While we will require Arizona Water to make "best faith efforts" to include the cities in its development of the CAP Water Use Plan, we do so with the hope that Casa Grande will in turn make its "best faith efforts" to keep in mind that Arizona Water, and not Casa Grande, is the party who must ultimately take responsibility for planning the best use of its CAP water allocation.

The Company objects to Staff's proposed fourth condition, which requires Staff approval of the Company's CAP Water Use Plan prior to a finding of sufficiency in the Company's next rate case, and to Staff's proposed fifth condition, which requires collected CAP Hook-Up Fees to be refunded in the event the Company's CAP Water Use Plan is disapproved in the Company's next rate case. We agree with RUCO that the fifth condition cannot harm the Company if it intends to act in good faith and present a reasonable CAP Water Use Plan, and find that this rationale also applies to the fourth condition.

Use of CAP water, which is a renewable resource, should be encouraged. The availability of CAP water comes at a cost, however, as the Company's deferred CAP M&I capital costs balance for its Casa Grande, Coolidge and White Tank systems shows.[4] The actual use of CAP water requires utilities to undertake substantial infrastructure investments. As Staff's witness testified, the balance of the payments the Company has made to retain the availability of its CAP water supply continues to increase, and if recovery is postponed until CAP water treatment infrastructure is built and the water is actually being served, ratepayers will be struck "twice as hard as they would have to be" (Tr. at 1203). This is because the water treatment plant would be placed in rate base at the same time that the Company would begin recovery of the deferred CAP M&I charges (*id.*) We agree with Staff that in order to prevent this "double hit," that with the safeguard conditions recommended by Staff, it is in

[4] At December 31, 2003, the deferred CAP M&I capital charge balance for the Casa Grande system was $3,525,803 (Hubbard Rj. Sched. SLH-RJ4 at 8, line 15); for Coolidge, $1,046,011 (*id.* at 12, line 15); and for White Tank, $506,269 (*id.* at 10, line 15).

the public interest to allow recovery of the deferred and ongoing CAP M&I capital charges to begin now with the collection of a special hook-up fee from new customers who will have the use of the Company's CAP allocation.

For all the above reasons, we therefore adopt, and approve herein, the CAP Hook-Up Fee tariffs attached hereto as Exhibits A, B, and C,[5] subject to Arizona Water's compliance with the requirements set forth in Staff's recommended "Conditions for Approval of a CAP Hook-Up Fee" as set forth above. We also find reasonable, and therefore adopt, Staff's recommended requirements for the CAP Water Use Plan as set forth above. The CAP M&I charges recovery schedules attached to this Decision as Exhibits D, E, and F demonstrate the derivation of the CAP Hook-Up Fee amounts. These are the recovery schedules proposed by Staff, except that the schedule for the Casa Grande system, Exhibit D, has been modified to adjust the test year end balance of CAP M&I capital charges in order to remove $142,896 associated with the 279 acre feet of the Company's Casa Grande system CAP allocation that was used and useful during the test year and will therefore be accorded rate base treatment in this proceeding over the same amortization period as the Hook-Up Fees, as discussed above. This change results in a reduction of the Hook-Up Fee for the Casa Grande system from $220 to $208 for 5/8 x 3/4-inch, 3/4-inch, and 1-inch meter sizes. In accordance with Staff's proposed seventh condition, if the CAP Hook-Up Fee is continued, the recovery schedules are subject to amendment in the Company's next rate case, when the projections can be trued-up to reflect actual figures and new projections of CAP M&I capital charges, NP-260 Tariff M&I charges, hook-up fees, and AFUDC. We will require the Company to provide, in its next rate filing, the data necessary to true-up the projections in these schedules for our review.

[5] In response to an issue raised during the hearing by Pivotal, Staff's witness added language to its proposed CAP Hook-Up Fee tariffs to clarify the point in time that an applicant for the installation of new water facilities would be required to advance costs for service connections. This clarifying language has been included in the tariffs.

B. Capitalized Legal Expenses

Arizona Water's application included $824,374 in rate base for its Casa Grande system, in plant in service Account 303 – Other Intangibles. This amount is related to legal and other fees the Company incurred between 1999 and 2003 in legal disputes to which the Company and Casa Grande were parties. The Company provided a breakdown of this amount at the hearing (Hrg. Exhibit A-21), and reduced the amount by $8,113 at the hearing (Tr. at 572, Co. Br. at 17). The Company argues that ratepayers benefited from the Company's decision to incur these costs. The Company asserts that its Casa Grande system ratepayers have benefited from the Company's decision to incur legal costs to defend a condemnation suit brought by Casa Grande, based on Arizona Water's assumption that some of its ratepayers would have had to pay for a higher cost of service had the condemnation suit been successful (Co. Br. at 19). The Company argues that the fact that residents of Casa Grande financed their city's condemnation action should not prevent the Company from recovering its legal costs in rates (Co. Reply Br. at 17). The Company also argues that ratepayers would have benefited had the Company prevailed in a suit it brought against Casa Grande seeking to bar the City from selling effluent in Arizona Water's service territory.

While the Company states on brief that it is seeking authority to include "$767,454 of capitalized legal expenses in rate base" (Co. Reply Br. at 13), it has not proposed to remove $48,807 in franchise, hydrology study, and what appear to be legal costs booked to this account in 2001, 2002 and 2003 as shown by Hearing Exhibit A-21. Staff has recommended an adjustment removing the entire $824,374 in the Company's Casa Grande system's Account 303 from rate base on the grounds that the costs benefited shareholders and not ratepayers (Ludders Dt. at 16, Sched. REL-5). The Company suggested at the hearing that the disputed costs it wants to capitalize could be amortized and accordingly would not remain in rate base forever (Tr. at 574, 587).

We agree with Staff that preservation of Arizona Water's business in Casa Grande benefits

the Company's shareholders, not ratepayers (Ludders Dt. at 16), and that if Casa Grande's condemnation had succeeded, the Company's ratepayers would continue to receive service from the new provider (*id.*). While the Company has every right to choose to take legal action, ratepayers should not be forced to shoulder the financial risk of legal action taken to benefit shareholders. We reject the Company's arguments that ratepayers benefited from the actions in question. The Company did not provide a quantitative representation of the benefit it alleges. Because the condemnation did not succeed, any estimation of the resulting cost of service to ratepayers is purely speculative. We also find questionable any benefit the Casa Grande system ratepayers might have received had Arizona Water won the right to be the exclusive provider of effluent in its Casa Grande service territory.

The costs appearing on Hearing Exhibit A-21 described as "Non-condemnation/effluent charges" should not have been placed in this Account 303, because they are not condemnation fees relating to acquiring land (*see* Tr. at 1233-1234, Hrg. Exhibits S-37, S-38). All but $12,749 of these costs were incurred outside the test year, and therefore are not recoverable as operating expenses. The 2003 costs of $12,749 labeled as "Franchise" on Hearing Exhibit A-21 are not a normally recurring annual expense and likewise are not recoverable as operating expenses. Staff's adjustment removing the $824,374 from rate base is reasonable, and it will be adopted.

C. Cash Working Capital

The Company's application includes a total working capital allowance of $311,323 for the Western Group. Staff is recommending a negative working capital allowance of ($91,645) for the Western Group, and RUCO is recommending a Western Group working capital allowance of $42,556. The parties do not dispute that the most accurate way to measure working capital requirements is via a lead/lag study. The purpose of a lead/lag study is to estimate the average amount of funds either supplied by shareholders or received in advance from ratepayers for business

operations (Ludders Dt. at 6). If cash is received from ratepayers prior to its use, a reduction is made to rate base to reflect the actual amount of working capital provided by the ratepayers, and likewise, when the Company makes payments prior to receiving cash from ratepayers, rate base is increased to reflect the additional funds provided by shareholders (*id.*). The difference between the parties' working capital recommendations is attributable mainly to differences in the number of income tax lag days each party proposes.

The Company determined its proposed working capital allowance using the lead/lag factors adopted in the Eastern Group Decision: 2.52 lag days for federal income taxes and 27.05 lag days for state income taxes, based on a one-month service period (Hubbard Rb. at 10-12). Staff calculated 37 days as the appropriate number of lag days for both federal and state income tax (Ludders Sb. at 4). Staff developed its proposed 37 day lag using the required quarterly payment dates for federal and state income tax payments, and a service period mid point of June 30, the middle of the annual tax payment period (*id.*). RUCO recommends 61.95 lag days for federal income taxes and 99.80 lag days for state income taxes, using July 1 as the service period midpoint (Coley Dt. at 14 and Sched. TJC-8 at pp. 4-5). For comparison purposes, RUCO provided the lead/lag days either authorized or requested by four of the largest utilities in Arizona, who also pay taxes quarterly (Coley Sb. at 4).[6]

As RUCO's witness explained, cash working capital is designed to provide a company with available cash on hand to cover any difference in time period from when revenues are received and when expenses must be paid, not when the expenses are booked (Coley Sb. at 3; Tr. at 975). The Company states that it calculates its lag day calculation for federal and state income taxes based on a

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[6] RUCO provided the following comparison of lag days proposed by Arizona utilities that recently had a rate case or have a rate case proceeding pending:

Company	Federal Tax Lag Days	State Tax Lag Days	Composite Federal/State Tax Lag Days
APS	60	62	-
Qwest	80	18	-
TEP	-	-	42.41
SWG	-	-	37

(Coley Sb. at 4).

monthly recording of income taxes, because that is when the income earned gives rise to the tax liability (*id.* at 11). However, although Arizona Water may book its tax liability monthly, tax payments are made quarterly (*id.*; Tr. at 975). The Company's practice of using a service period of the month in which the tax liability accrues inaccurately presumes that a cash payment is being made when the expense is recorded each month, and not when the cash payment is actually made, on a quarterly basis (Coley Sb. at 5). Moreover, the Company's tax liability is not based on revenues received in a monthly service period, or even a quarterly service period, but on annual revenues. RUCO's witness points out that the Company's 2.52 lag day calculation equates to a weekly payment period (Tr. at 987).

The Company argues that because its lag day calculation was accepted in prior Arizona Water Decisions for the Northern and Eastern Group, it must again be adopted in this case, while Staff and RUCO recommend that the issue be reconsidered. RUCO and Staff's arguments are persuasive, and reconsideration is appropriate. We find, based on the evidence, that lag days should be calculated based not on the monthly service period when the Company records income tax liabilities, but on the annual service period upon which the Company's tax liability is based; and should consider the time income taxes are due, which is quarterly, not monthly. As Staff's witness states, if the Company wishes to pay its taxes earlier than when required, it can certainly do so, but the negative cash flow consequences of this practice should not penalize ratepayers (*see* Ludders Sb. at 4). The fact that the Company records its tax liability on a monthly basis does not justify an excessive working capital allowance. We find that Staff's calculation of 37 lag days for both federal income taxes and state income taxes, which is based on quarterly tax payments and an annual service period provides an accurate and reasonable measure of an appropriate amount of cash working capital for Arizona Water's Western Group, and will adopt it.

III. ORIGINAL COST RATE BASE

Based on the foregoing discussion, we adopt an adjusted original cost rate base ("OCRB") for the Western Group of $23,254,087. By system, the OCRB is as follows: Casa Grande, $17,495,567; Coolidge, $2,713,030; White Tank, $1,898,133; Ajo, $837,088; and Stanfield, $310,269.

IV. FAIR VALUE RATE BASE

The Company did not submit reconstruction cost new less depreciation ("RCND") schedules, but stipulated in its application to the use of its OCRB as its fair value rate base ("FVRB") (Application at 3). We therefore adopt $23,254,087 as the FVRB for Arizona Water's Western Group. By system, the FVRB is as follows: Casa Grande, $17,495,567; Coolidge, $2,713,030; White Tank, $1,898,133; Ajo, $837,088; and Stanfield, $310,269.

V. OPERATING INCOME

A. Revenue Annualization

There is no dispute that an adjustment to the test year annualizing revenues and expenses to recognize the effects of the number of customers served by the Western Group at the end of the test year is appropriate. According to the Company, the test year end number of customers was 20,266, and during the test year, the Company served an average of 19,596 customers, a difference of 670 customers (Hubbard Dt. at 25). The Company compared the year-end number of customers to the number of customers at the beginning of the test year to calculate the average number of test year customers (Tr. at 760). The Company's calculation is based on the number of residential customers, as this class of customers constitutes 96 percent of the growth in customers in the Western Group (*id.*). The Company bases its expense annualization adjustment on costs per customer for customer accounts expense and transmission and distribution expenses (including operations and maintenance costs), and on costs per gallon for source of supply, pumping and water treatment expenses (Hubbard Rb. at 24).

While Staff adopted the Company's revenue and expense annualization adjustment (Tr. at 1238-1239, 1318-1320), RUCO proposed an alternative adjustment (Coley Dt. at 16-20). RUCO disagrees with the Company's averaging methodology for determining test year growth, and prefers to calculate the difference between the number of customers at the beginning of the test year and the number at the end of the test year (*id.* at 16). RUCO's calculation is based on all customer classes rather than residential customers (Tr. at 998). RUCO's proposed adjustment does not include transmission and distribution expense (*id.* at 18), and includes only operations expense associated with water treatment expense, while excluding maintenance expense. RUCO based its determination that transmission and distribution expenses item is not impacted by a change in customer levels on a regression analysis it performed based on data from 1992-1999 for Arizona Water's Northern Group case (*id.* at 18, Hubbard Rj. at 11). RUCO later performed an updated regression analysis using 1999-2003 data and determined that transmission and distribution expenses are affected by customer growth, but did not update its proposed annualization adjustment accordingly (Tr. at 996-998, 1000-1001).

In comparing the annualization adjustments proposed by the Company and RUCO, we find that while neither methodology is perfect, the Company's proposed adjustment provides the more reasonable estimate of the effects of customer growth on test year revenues and expenses. The Company's annualization adjustment properly uses residential customer growth, which represents the great majority of growth in the Western Group, whereas RUCO's use of growth in all customer classes results in an overstatement of test year revenue, as we explained in the Eastern Group Decision. In addition, RUCO's omission of transmission and distribution expenses and water treatment maintenance expenses from its annualization methodology results in an understatement of expenses, and RUCO chose not to update its estimates when it determined that transmission and distribution expenses should have been included. While RUCO is critical of Arizona Water's

methodology using the average number of test year customers to measure growth, Staff accepted the Company's methodology using the test year average number of customers because it is commonly employed by water utilities and is one of many acceptable methods (Tr. at 1318-1320). Staff's witness stated, however, that RUCO's growth determination methodology may be preferable. While we accept the Company's methodology in this case, as we did in the Eastern Group case, we expect the Company to use end of test year customer counts in its next rate case for annualization purposes. The annualization adjustment proposed by the Company and adopted by Staff is reasonable and will be adopted in this proceeding.

B. Purchased Power Expense

RUCO proposed a pro forma adjustment to the Company's purchased power expense for all five systems that takes into consideration both APS' recent rate increase and RUCO's recommendation to eliminate Arizona Water's purchased power adjustor mechanism (Rigsby Dt. at 27). RUCO's adjustment would increase the Company's test year costs for APS power by 3.5 percent across the board, for an overall increase for the Western Group of $16,361 (*id.*, Sched. WAR-12; Coley Dt. Sched. TJC-12). On rebuttal, Arizona Water stated that the new APS rate design is more complex than the design in effect during the test year, and that it needed additional time to ensure accurate application of the new rates (Hubbard Rb. at 21-22). In its rejoinder testimony, Arizona Water proposed a pro forma adjustment increasing its test year purchased power expense for the Western Group systems by a total of $22,779 (Hubbard Rj. at 8, 9).[7] Arizona Water's witness stated that RUCO's pro forma adjustments did not incorporate APS' Rate E-221 change, but instead applied the APS' 3.5 percent rate increase for Rate E-32 to all of the Company's test year purchased power expense (*id.* at 9). Ms. Hubbard explained that the Company's proposed adjustment

[7]By system, the Company's proposed adjustment would increase purchased power expense for the Ajo system by $58; for Stanfield by $647; for Coolidge by $1,861; for Casa Grande by $24,540; and would decrease purchased power expense for White Tank by $4,327 (Hubbard Rj. at 9).

incorporates the effects of the APS rate increase under both tariffs Rate E-221 and Rate E-32, and is based on the Company's test year power usage patterns under each applicable tariff (*id.*).

At the hearing, RUCO's witness proposed changes to its pro forma adjustment resulting from its application of a 3.5 percent increase to the Company's test year billed E-32 rates and a 5 percent increase to the Company's test year billed E-221 rates (Tr. at 1034-1036, 1041). RUCO's revised pro forma adjustment calls for a total system-wide increase in purchased power expense of $22,755 (*id.* and Scheds. WAR-12; TJC-12).[8] RUCO argues on brief that its adjustment should be adopted because the Company's adjustment lacks foundation and there is no basis in the record to support a finding that it is a correct adjustment (RUCO Reply Br. at 6). We disagree. As Arizona Water's witness Hubbard explained, the new APS rate design is more complex than the design in effect during the test year (Hubbard Rb. at 21-22), and one of the new APS tariffs has been modified from the design in effect during the test year from a kilowatt hour rate basis to a demand charge on a per kW basis, and depending on a specific facilities' usage, the new tariff might put the facility into the demand component where it would have been billed on a kilowatt hour basis during the test year (Tr. at 820). Arizona Water's adjustment is based on a review of the new tariffs' effects by an Arizona Water employee responsible for reviewing its APS power bills on a monthly basis (Tr. at 819). We find that the Company's pro forma adjustment is supported by the evidence, and that it is reasonable to adjust the Company's purchased power expense accordingly, based on these known and measurable changes to test year expenses. The Company's pro forma adjustment will therefore be adopted.

C. CAP M&I Capital Charges-Related Expense

As stated above, Arizona Water's application included a pro forma adjustment to purchased

[8] By system, RUCO's proposed adjustment would increase purchased power expense for the Ajo system by $10; ; for Stanfield by $873; for Coolidge by $1,835; for Casa Grande by $16,897; and for White Tank by $3,140 (Tr. at 1034-1036 and Scheds. WAR-12; TJC-12).

water expense and a pro forma adjustment to test year depreciation and amortization expense to reflect ongoing CAP M&I capital charges and the amortization of deferred CAP M&I capital charges for the Casa Grande, Coolidge, and White Tank systems. Since the Company is being authorized to recover the ongoing and deferred CAP M&I charges via the CAP Hook-Up Fee tariff approved herein as discussed above, these pro forma adjustments will not be adopted.

D. Rate Case Expense

Arizona Water's application included an estimate of $253,550 in rate case expense, amortized over three years (Hubbard Dt. at 31), and the application proposed to update its request for recovery of rate case expense at the reply brief stage of this proceeding (*id.* at 25). The Company did not, however, increase its request. RUCO does not propose an adjustment to rate case expense, but recommends against approval of expense beyond the Company's original estimate of $253,550, based on the complexity of this proceeding, the number of systems involved, and a comparison to other cases (RUCO Reply Br. at 11). RUCO states that this case involves fewer divisions than the prior Northern Group and Eastern Group cases, in which allowed rate case expense was $217,000 and $250,000 respectively (*id.*).[9] Staff recommends rate case expense of $225,000 (Ludders Dt. at 11). Staff asserts that the Western Group is smaller than the Eastern Group and that the Eastern Group case had a contentious issue not present in this proceeding (Staff Reply Br. at 10).

It is undisputed that the Western Group is smaller than the Eastern Group in that it has less rate base, less revenue, less operating expenses, and fewer systems (*see* Tr. at 798-799). As the Company points out, while the Eastern Group proceeding and this proceeding are comparable, this proceeding also had a complex issue, the CAP cost recovery mechanism, that was not present in the Eastern Group case, and this case involved more substantial participation by the City of Casa Grande than did the Eastern Group case. Based on the complexity of this proceeding, the number of systems

[9] The Northern Group case involved five systems, and the Eastern Group case involved eight systems.

involved, and a comparison to other cases, we find that it is reasonable to allow rate case expense of $250,000 in this case, amortized over three years.

E. Property Tax Expense

The methodology used by the Company and Staff to estimate property tax expense, which is to use adjusted test year revenues and the projected revenues under the newly approved rates as inputs to the ADOR assessment formula, is the same methodology adopted in numerous prior cases over the objections of RUCO.[10] RUCO proposes, as it has many times before, to instead use revenues from the test year and the two years prior to the test year to calculate property tax expense (Tr. at 1003). RUCO has not demonstrated a basis for departure from our prior determinations on this issue. RUCO's argument regarding regulatory lag (RUCO Br. at 14, RUCO Reply Br. at 7-8) has been advanced and rejected (*see Rio Rico Utilities,* Decision No. 67279 (October 5, 2004)). Regulatory lag is inherent to the regulatory process, working sometimes to the benefit of ratepayers and sometimes to the benefit of shareholders. Its existence does not provide a justification for understating a utility's property tax expense. RUCO's calculation methodology, which uses only historical revenues, unfairly and unreasonably understates property tax expense, and is therefore inappropriate for ratemaking purposes. The Company and Staff's calculation for property tax expense yields the best estimate of Arizona Water's property tax expense for the period in which new rates will be in effect.

Based on the revenue requirement we adopt herein, and utilizing the methodology adopted by the Commission in our prior Decisions, an allowance will be made for property tax expense in the amount of $768,963 on for the Western Group systems. This figure includes an estimation of the

[10] *E.g., Chaparral City Water,* Decision No. 68176 (September 30, 2005) (finding that RUCO's calculation methodology, which uses only historical revenues, unfairly and unreasonably understates property tax expense, and is therefore inappropriate for ratemaking purposes); *Rio Rico Utilities,* Decision No. 67279 (October 5, 2004) (finding that use of only historic revenues understates the expense level); *Arizona American Water Company,* Decision No. 67093 (June 30, 2004); *Bella Vista Water Company,* Decision No. 65350 (November 1, 2002); *Arizona Water Company,* Decision No. 64282 (December 28, 2001). RUCO has not appealed any of these Decisions.

effects of recently enacted Arizona House Bill 2779, which will gradually lower the assessment ratio for Class 1 properties, such as utility property, from 25 percent to 20 percent over a ten year period, by means of a reduction in the assessment ratio of ½ percent a year. By system, property tax allowance is as follows: Casa Grande, $583,331; Coolidge, $104,176; White Tank, $46,367; Ajo, $24,552; and Stanfield, $10,537.

Because an allowance for the property tax expense of Arizona Water is included in the Company's rates and will be collected from its customers, the Commission seeks assurances from the Company that any taxes collected from ratepayers have been remitted to the appropriate taxing authority. It has come to the Commission's attention that a number of water companies have been unwilling or unable to fulfill their obligation to pay the taxes that were collected from ratepayers, some for as many as twenty years. It is reasonable, therefore, that as a preventive measure Arizona Water annually file, as part of its annual report, an affidavit with the Utilities Division attesting that the Company is current in paying its property taxes in Arizona.

F. Statement of Operating Income

Arizona Water's adjusted Western Group test year operating revenues were $10,675,355. In accordance with the discussion herein, the Company's adjusted test year Western Group operating expenses for ratemaking purposes total $8,704,066 for an adjusted Western Group test year net operating income of $1,971,289.

By system, Arizona Water's adjusted Casa Grande test year operating revenues were $7,921,381, and adjusted test year operating expenses for ratemaking purposes were $6,419,127, for an adjusted Casa Grande system test year adjusted net operating income of $1,502,254.

Arizona Water's adjusted Coolidge test year operating revenues were $1,427,285, and adjusted test year operating expenses for ratemaking purposes were $1,191,676, for an adjusted Coolidge system test year net operating income of $235,609.

Arizona Water's adjusted White Tank test year operating revenues were $783,483, and adjusted test year operating expenses for ratemaking purposes were $611,901, for an adjusted White Tank system test year net operating income of $171,582.

Arizona Water's adjusted Ajo test year operating revenues were $412,203, and adjusted test year operating expenses for ratemaking purposes were $375,293, for an adjusted Ajo system test year net operating income of $36,910.

Arizona Water's adjusted Stanfield test year operating revenues were $131,003, and adjusted test year operating expenses for ratemaking purposes were $106,069, for an adjusted Stanfield system test year net operating income of $24,934.

VI. COST OF CAPITAL

Arizona Water, Staff and RUCO presented cost of capital analyses for purposes of determining a fair value rate of return in this proceeding. Arizona Water proposes a cost of capital and rate of return of 10.50 percent; Staff recommends 8.9 percent; and RUCO recommends 9.17 percent.

A. Capital Structure and Cost of Debt

1. Capital Structure

The parties are in agreement that Arizona Water's company-wide capital structure as of December 31, 2003 should be used to determine the Company's weighted cost of capital, as follows (Hrg. Exhibit A-17; Ramirez Dt. at 6; Rigsby Dt. at 41):

Long Term Debt	$ 22,200,000	26.6%
Common Equity	61,116,374	73.4%
Total Capital	$ 83,316,374	100%

2. Cost of Debt

The parties also agree that the Company's cost of long term debt is 8.4 percent, which results in a weighted cost of debt of 2.2 percent (*id.*).

B. Cost of Equity

While the cost of debt can be determined from fixed cost rates, the cost of equity component of the Company's capital structure can only be estimated. Staff advocates a cost of equity of 9.1 percent and RUCO advocates a cost of equity of 9.44 percent, based on the analyses of their witnesses. Arizona Water advocates a return on equity of 11.25 (Zepp Rj. at 4) which includes a minimum 50 basis point risk premium (Zepp Rb. at 3-5).

Arizona Water's cost of capital expert witness Zepp prepared estimates of the cost of equity based on the discounted cash flow ("DCF") 1-step (constant growth) and 2-step (multi-stage growth) models used by the Federal Energy Regulatory Commission ("FERC"). The DCF method of estimating the cost of capital is based on the theory that the present value of a stock is equal to the present value of all expected future dividends or cash flows. The constant growth DCF model assumes that a company will grow at the same rate indefinitely, while the non-constant growth DCF model does not assume that dividends grow at a constant rate over time. The constant-growth DCF formula includes three variables used to estimate the cost of equity: 1) the expected annual dividend; 2) the current stock price; and 3) the expected infinite annual growth rate of dividends ("dividend growth rate"). The constant-growth DCF model calculates a dividend yield by dividing the expected annual dividend by the current stock price, and then adds the resulting dividend yield to the expected infinite annual growth rate of dividends. The multi-stage growth DCF model assumes investors expect different rates of growth in the initial period and subsequent period. Dr. Zepp's equity estimates are also based on the risk premium method used by the California Public Utility Commission staff ("CPUC staff"). The updated equity cost estimates presented in Zepp's rejoinder testimony using these approaches are 10.2 percent using the FERC 2-step DCF model (Zepp Rj. Table 4), 10.4 percent using the FERC 1-step DCF model (Zepp Rj. Table 3), 10.5 percent using the CPUC staff risk premium methodology, and 10.9 percent using his modification of the CPUC staff

risk premium methodology (Zepp Rj. at 8, Tables 5-7), based on the six publicly-traded water utilities included in the sample group.[11] Dr. Zepp disagrees with the CPUC staff methodology's use of realized returns on equity as equity cost proxies, based on his belief that they might understate the cost of equity (Zepp Rj. at 8-9).

Dr. Zepp also "restated" the analyses of Staff witness Ramirez and RUCO witness Rigsby using his preferred inputs from the information provided in these witnesses' testimony, schedules and workpapers, to reach differing equity cost estimates. In rebuttal testimony, Dr. Zepp used the FERC 1-step and 2-step DCF models using prices, dividends and long-term growth rates chosen from Staff witness Ramirez' workpapers and schedules, and reached an equity cost estimate of 11.2 percent to 11.5 percent. (Zepp Rb. at 12-14 and Tables 5 and 6). Dr. Zepp also restated Mr. Ramirez' constant growth and multi-stage DCF models using different inputs and produced an average cost of equity estimate of 10.9 percent (Zepp Rb. at 18-20 and Tables 7-10), and restated Mr. Ramirez' capital asset pricing model ("CAPM") estimate using long-term instead of intermediate-term Treasury rates and Dr. Zepp's preferred methodology for estimating the current market risk premium, reaching an estimate of 11.1 percent (Zepp Rb. at 20-26). Dr. Zepp's rebuttal restatements of Staff witness Ramirez' cost of equity estimates resulted in an average of 10.6 percent (Zepp Rb. Table 12). In rejoinder testimony, Dr. Zepp again restated Staff witness Ramirez' constant growth and multi-stage growth DCF model estimates, and Ramirez' CAPM estimates, using information from Ramirez' testimony and workpapers. These restatements of Staff witness Ramirez' cost of equity estimates were as follows: constant growth DCF, 10.5 percent (Zepp Rj at 12 and Table 11); multi-stage growth DCF, 9.9 percent; and CAPM, 10.1 percent (Zepp Rj. at 16, 18 and Table 11). Dr. Zepp also

[11] The Company and Staff used the same six publicly-traded water utilities as proxies in their analyses: American States Water, Aqua America, California Water Service, Connecticut Water Services, Middlesex Water Company and SJW Corp. RUCO used the three largest publicly-traded water utilities in this group in its analysis: American States Water, Aqua America and California Water Service. These companies represent the water utilities that are currently analyzed by the *The Value Line Investment Survey Small and Mid Cap Edition* and *The Value Line Investment Survey ("Value Line").*

restated RUCO witness Rigsby's constant growth DCF model cost of equity estimate in two different ways based on Mr. Rigsby's data but using Dr. Zepp's preferred inputs, and produced equity cost estimates ranging from 10.3 percent to 11.0 percent (Zepp Rj. 29-31 and Table 11).

Arizona Water criticizes Staff's constant growth and multi-stage DCF estimates, asserting that they understate the cost of equity because they used spot stock prices to compute the dividend yield; gave 50 percent weight to historic growth rates; used geometric averages instead of arithmetic averages to determine forward-looking estimates of growth from past growth in dividends per share ("DPS") and earnings per share ("EPS"); and while Staff used 50 percent-weighted forward-looking growth estimates in its constant-growth DCF model estimate, it did not use forward-looking growth estimates in its multi-stage DCF model. Regarding Staff's CAPM estimates, Arizona Water claims that they are also too low due to the inputs Staff chose. The Company disagrees with Staff's use of the betas estimated by *Value Line* for the six water utilities in the sample group to compute an average beta[12] of 0.68; Staff's use of the average yield on intermediate-term (i.e., five-year, seven-year, and ten-year) Treasury securities as the risk-free rate while using the long-term Treasury rate to estimate the market risk premium; and Staff's use of the DCF model to estimate the current market risk premium. Arizona Water argues that it is a more risky investment than the sample utilities, and its beta would therefore be closer to 1.0, which would result in a higher equity cost estimate, and that Staff's CAPM estimate does not properly take into account empirical studies that indicate the risk-free rate is higher than the rate on long-term Treasury bonds for low beta stocks like the sample water utilities. Dr. Zepp believes that the risk premium method used by the CPUC staff is preferable to the CAPM, because the CPUC staff method directly estimates a risk premium by comparing authorized and actual returns on equity (although he disagrees with this method's use of realized returns, *see* Zepp Rj. at 8-9) with the current yield of investment grade bonds or other debt instruments (Zepp Dt.

[12] Beta measures the systematic risk of a company. The market's beta is 1.0; therefore, a security with a beta higher than 1.0 is riskier than the market, and a security with a beta lower than 1.0 is less risky than the market.

at 38-39), while the CAPM measures the risk premium indirectly, requiring more assumptions to be made, which Dr. Zepp believes leads to a higher likelihood of error (Zepp Dt. at 5, 34).

Arizona Water claims that at least 50 basis points must be added to its cost of equity estimates to account for additional risk it believes is related to the rate-setting system in Arizona which the Company believes are not faced by the water utilities in the sample group, such as Arizona's use of an historic test year with limited adjustments for post-test year changes; elimination of adjustment mechanisms; recovery of CAP-related costs; arsenic cost recovery; and revenue instability caused by inverted-tier rate designs. The Company claims its proposed risk adjustment is supported by the fact that while five of the six utilities in the sample group have bond ratings of A or higher, Arizona Water's most recent bond issue had a cost of debt 37 basis points above the cost of A-rated bonds and 49 basis points above AA-rated bonds.

Staff's witness Ramirez prepared his 9.1 percent estimate of the cost of equity using a constant growth DCF model, a multi-stage, or non-constant growth DCF model, and a CAPM analysis. To calculate dividend yield in its constant-growth DCF calculation, Staff divided the expected annual dividend as forecasted by *Value Line* by the spot stock price on May 11, 2005 (Ramirez Sb. at 2). Staff used a spot stock price, rather than a historical average of stock prices, in order to be consistent with the efficient markets hypothesis of finance theory, which holds that the current stock price includes investors' expectations of future returns and is the best indicator of those expectations.[13] Staff then added the resulting dividend yield to its estimate of a dividend growth rate.

To reach its dividend growth rate determination, Staff used a combination of historical and projected DPS growth provided by *Value Line*, and also examined historical and projected growth in EPS and intrinsic growth (Ramirez Dt. at 16). Staff's analysis yielded an average of projected and

[13] Ramirez Dt. at 2. Use of spot market price has been adopted in recent Commission Decisions, including *Chaparral City Water Company*, Decision No. 68176 (September 30, 2005), *Arizona Water Company*, Decision No. 66849 (March 19, 2004), and *Arizona-American Water Company*, Decision No. 67093 (June 30, 2004).

historic growth rates of 5.8 percent (Ramirez Sb. Sched. AXR-6), which it added to Staff's dividend yield calculation of 3.0 percent, producing Staff's constant growth DCF estimate of 8.8 percent (Ramirez Sb. Sched. AXR-8). Staff's multi-stage DCF model incorporates both a near-term growth rate and a long-term growth rate to account for the assumption that investors expect dividends to grow at a non-constant rate in the near term (stage 1 growth) and then to grow at a constant rate in the long term (stage 2 growth) (Ramirez Dt. at 23-34). To calculate its stage 1 growth, Staff forecasted four years of dividends for each of the utilities in the sample group using expected dividends over the next twelve months for the first year and *Value Line's* projected DPS growth rate for the subsequent years (Ramirez Dt. at 25; Sb. Sched. AXR-7). To estimate its stage 2 growth, Staff used the 6.5 percent rate of GDP growth from 1929 to 2004 because this historical growth rate assumes that the water utility industry is expected to grow neither faster nor slower than the overall economy (Ramirez Dt. at 25). Staff reached a multi-stage DCF estimate of 9.3 percent (Ramirez Sb. Sched. AXR-7). Staff calculated its overall DCF estimate of 9.0 percent by averaging the results of its constant growth and multi-stage DCF estimates (*id.*).

Staff also performed a CAPM analysis on the sample water utilities used in Arizona Water's and Staff's DCF analyses. Mathematically represented, the CAPM formula states that the expected return on a risky asset is equal to the prevailing risk-free interest rate plus the market risk premium which is adjusted for the riskiness (beta) of the investment relative to the market. Averaging the yields on five, seven and ten year Treasury notes according to the March 24, 2005 edition of *The Wall Street Journal,* Staff estimated the risk-free rate to be 4.45 percent (Ramirez Dt. at 27), and estimated Arizona Water's beta to be 0.68 by averaging the *Value Line* betas of the sample water utilities (*id.*). Staff's CAPM analysis used a historical market risk premium estimate, reaching an estimate of 9.1 percent, and a current market risk premium estimate, reaching an estimate of 9.3 percent, to reach its overall CAPM estimate of 9.2 percent (*id.* at 28-29; Ramirez Sb. Sched. AXR-8).

Based on its DCF and CAPM estimates, Staff recommends a cost of equity of 9.1 percent. Staff's cost of capital estimate does not include a leverage adjustment (Ramirez Sb. at 1-2), but Staff recommends that if a higher cost of equity is adopted, a leverage adjustment should also be adopted to account for Arizona Water's low level of debt as compared to the sample group of utilities.

RUCO reached its 9.44 percent recommended cost of common equity based on the DCF analysis performed by its witness Mr. Rigsby (Rigsby Cost of Capital Dt. at 27; Rigsby Sb. at 27). Mr. Rigsby derived his growth estimates for his DCF calculation from both historical data and analysts' projections. The proxy companies Mr. Rigsby used for his sample group include three of the six companies in the sample group used by the Company and Staff. Mr. Rigsby did not include the other three companies in his proxy group because *Value Line* does not provide the same type of long-term estimates on ROE and share growth it provides for the three larger companies he used (Rigsby Cost of Capital Dt. at 18). RUCO believes its recommended 9.44 percent cost of common equity is appropriate given the current environment of low inflation and low interest rates, and points out that it made no downward adjustment to its DCF model results to account for the fact that the Company's capital structure of 73 percent common equity and 27 percent debt is less leveraged than the capital structure of the publicly traded water providers, which averaged 56 percent equity and 44 percent debt.

We believe that Staff's analysis is based on sound economic principles, and has produced a cost of equity estimate that represents a fair and reasonable estimate of Arizona Water's cost of equity for purposes of this proceeding, and which will produce a return commensurate with returns on investment in other enterprises with risk corresponding to that of the Company. While Arizona Water finds fault with Staff's analysis, the Company's analysis has several weaknesses.

The Company's DCF estimates varied significantly from Staff and RUCO's estimates due primarily to differences in its dividend growth estimation. We note that while the Company

criticized Staff and RUCO for choosing inputs that "depressed" their cost of equity estimates, the Company's choices resulted in higher cost of equity estimates. Relying solely on analysts' forecasts of the short-term growth rate of the water industry produces less reasonable estimates than does averaging historical growth rates with growth rate forecasts, because analysts' forecasts are known to be optimistic. DPS and past EPS growth are indicators investors would consider in estimating growth, as Arizona Water's witness Zepp has testified (*see* Ramirez Dt. at 47; Sb. at 18). We are not convinced that the methodology FERC uses to estimate cost of capital for the interstate gas and electric companies it regulates is appropriately applied to monopoly water utilities. The FERC DCF multi-stage analysis advocated by the Company relies more heavily on analysts' forecasts than on GDP growth, which is based on empirical evidence as opposed to conjecture. While Dr. Zepp criticizes Staff's use of the geometric average, and not the arithmetic average, of GDP growth, we find Staff's use of the geometric average to be appropriate because it provides a better representation of long-term performance. We find that Staff's DCF methodology provides a more reasonable cost of equity estimate than the Company's.

In estimating its cost of equity, Arizona Water relied on a risk premium analysis methodology used by the CPUC staff, which uses comparisons to actual or authorized returns on equity. This sort of "comparable earnings" analysis has long been discredited for several reasons, one of them being the circularity of setting returns based on the returns set in other regulatory proceedings. Market-based methods like the DCF model and the CAPM provide more reliable estimates of equity cost, because it is capital markets, and not regulatory commissions, that determine the cost of equity. Use of the risk premium analysis urged by the Company would circumvent the market forces that regulation attempts, as much as possible, to replicate. The Arizona Court of Appeals has strongly criticized the use of utilities as the sample group in a comparable earnings analysis.[14] The risk

[14] *See Sun City Water Co. v. Arizona Corp. Comm'n*, 26 Ariz. 464, 556 P.2d 1126 (1976).

premium analysis methodology erroneously assumes that accounting-based "actual" ROEs are equal to the cost of equity. Although certain ROEs may have been allowed in prior regulatory decisions, this Commission cannot rely on previously authorized ROEs because it cannot know the particulars behind each case, or cross-examine witnesses even if the particulars were known, to determine their relevance to Arizona Water.

We believe Staff's CAPM analysis, which includes a risk variable, is a reasonable means of estimating Arizona Water's cost of equity in this case and is preferable to the Company's proposed risk premium methodology recommendation. The Company's restatement of Staff's CAPM uses forecasts of long-term Treasury securities as its risk-free rate, as opposed to intermediate Treasury securities, but fails to subtract out the liquidity risk premium long-term Treasuries include, resulting in upwardly biased estimates. While the Company argues that its beta should not be the same as the average of the sample water utility company group, Arizona Water and the sample water companies are in the same business and should have on average the same systematic risk. Unique risk does not affect the cost of equity, because firm-specific risk can be eliminated through shareholder diversification. Staff's assumption that all water companies have similar betas is therefore reasonable. Arizona Water also argues that Staff's CAPM inputs must be flawed, because although interest rates have gone up since the Eastern Group case, Staff's CAPM estimate remains the same in this case. This argument ignores the fact that while interest rates have gone up, the cost of equity for the market as a whole has decreased, while the cost of equity for utilities has remained relatively stable. Staff states that while its witness in the Eastern Group case estimated an overall market risk premium at 13.1 percent, its current estimate is 7.8 percent (*compare* Schedule JMR-18 in Docket No. W-01445A-02-0619 (Eastern Group Decision docket) with Ramirez Sb. Sched. AXR-8), and this relative change in the risks of utilities as compared to the overall market is reflected in Staff's increased beta estimate, from 0.59 in the Eastern Group case to 0.68 in this case.

We agree with Staff that the cost of equity estimates reached by Staff's analysis do not require a downward risk adjustment in this case to account for the Company's equity-rich capital structure and accompanying reduced business risk. The record in this proceeding likewise does not support the 50 basis point or greater upward adjustment to equity cost advocated by Arizona Water. The Company's assumption that the spread between the costs of its last corporate bond issue and A-rated/AA-rated bonds is due to business risk, and therefore justifies an adjustment to its cost of equity, is unreasonable. The Company was successful in its bond placement. As Staff points out, the liquidity risk and business risk that are contained in corporate bonds do not affect a Company's cost of equity (Ramirez Sb. at 19-20). The Company submitted no data on the ratemaking systems of other states or the arsenic risks of other companies, or any other data demonstrating that the ratemaking system in Arizona contributes to greater business risk for Arizona Water than the sample group of water utilities. There is no precedent for recognizing a risk adjustment because the law requires use of a historical test year. Indeed, this Decision approves a recovery mechanism for the Western Group's deferred CAP M&I capital charges, despite the fact that the CAP water is not yet used and useful. For the reasons stated in the rate design discussion below, the implementation of conservation-oriented rate design likewise does not justify an upward adjustment to the Company's cost of equity. The risks associated with arsenic treatment costs have been mitigated by approval of an arsenic cost recovery mechanism ("ACRM") for the Company's Northern Group, Eastern Group, and in this case, Western Group systems which enables the Company to seek expedited approval of capital costs and a significant portion of operating costs associated with arsenic treatment for its affected systems. For the above reasons, we will not adopt any specific adjustments to the 9.1 percent cost of equity determined by Staff's analysis.

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C. **Cost of Capital Summary**

	Percentage	Cost	Weighted Cost
Long-Term Debt	26.6%	8.4%	2.2%
Common Equity	73.4%	9.1%	6.7%
Weighted Average Cost of Capital			8.9%

VII. AUTHORIZED INCREASE/DECREASE

With the adjustments adopted herein, the adjusted test year operating income is $1,971,289. Multiplying the Western Group's FVRB by the fair value rate of return produces a required operating income of $2,069,613 on a total Western Group basis. This is $98,324 more than the adjusted test year income under existing rates. The required increase in gross annual revenues for the Western Group is $160,510, or 1.50 percent. By system, the required increase in gross annual revenues is as follows: Casa Grande, $89,542; Coolidge, $9,551; White Tank, ($4,323); Ajo, $61,365; and Stanfield, $4,375.

VIII. RATE DESIGN

Arizona Water's application included a rate design similar to its current rate design, which includes a monthly minimum charge based on meter size and a single tier commodity rate for all gallons sold. As outlined in Section I.A above, Staff asked that the Company instead provide a three-tier inverted block rate design. Arizona Water chose not to propose an alternative three-tier rate design, but to advocate for the adoption of the single-tier commodity rate design included in its application. The Company's proposal differs from its current rate design in that it eliminates the 1,000 gallons of water currently included in the minimum monthly rate.

RUCO, Casa Grande, and Staff all oppose Arizona Water's proposed single-tier rate design.

Casa Grande opposes the Company's proposed rate design, because with the exception of the increase it would place on 8-inch meter sizes, it would place the highest percentage rate increase on 5/8 x 3/4-inch users and the Company has provided no supporting rationale for this effect (Co. Br. at

28). Casa Grande supports Staff's proposed three-tier inverted rate design because it makes water more affordable to the smallest, typically residential users (*id.* at 28-29), and because use of an inverted block rate design promotes the Commission's policy of encouraging conservation by sending the proper price signal (City Reply Br. at 15). In response to Arizona Water's argument that Staff's proposed rate design could affect the Company's opportunity to earn the authorized rate of return, Casa Grande asserts that because Arizona Water has not offered a current cost of service study or any reliable evidence demonstrating that the Company will lose revenue due to use of an inverted tier rate design (City Br. at 28), the Company is merely speculating on how water users might respond to an inverted tier rate structure (City Br. at 28, citing to Tr. at 601-610; 657-663). Casa Grande asserts that the Company's 1990 cost of service study is no longer current and accurate, due to changes in the Casa Grande system (City Br. at 28; Tr. at 852).

RUCO recommends a two-tier inverted block rate design structure with a breakover point at 4,000 gallons, which is approximately 6,095 gallons below the average level of consumption for the 5/8 x 3/4-inch meter size for all five systems (Coley Dt. at 24, 26). RUCO set the breakover point at this level so that customers on each of the five systems will experience a price signal as their consumption rises (Coley Dt. at 26). RUCO believes that its rate design, which does not discriminate between class or meter size, is fair because each customer pays the same commodity rate for the same level of usage (RUCO Br. at 17).

Staff proposes a rate design that includes three tiers of commodity rates for residential 5/8 x 3/4-inch meter sizes and two tiers for all other meter sizes. For the 5/8 x 3/4-inch residential meter sizes, breakover points are 3,000 gallons and 10,000 gallons, and larger meter sizes have increasingly greater breakover points, recognizing their greater demand. Like the Company, Staff proposed removing the 1,000 gallons currently included in the Company's minimum monthly charges. Under the rate design Staff proposed, a residential customer using no more than 3,000 gallons of water

monthly would experience a lower increase over current rates than heavier-usage customers whose monthly usage falls in the third tier. Due to the minimal revenue increases required by most of the Western Group systems in this case, implementation of a conservation-oriented three-tier rate design requires minimal rate decreases for most median and average usage customers, whose usage falls in the second tier.[15] Generally however, customers with usage falling in the third tier, with usage over 15,000 gallons, will experience percentage rate increases that are greater than the percentage revenue increases authorized in this Decision.[16] Staff states that the lower prices for the first two tiers are necessary in order to send a price signal to heavier water users in order to meet the long-term goal of encouraging conservation (Staff Reply Br. at 3). Staff argues that its rate design should be adopted in this case because it takes seriously the State's important policy goal of encouraging conservation in the long term, and is consistent with recent Commission decisions approving inverted tier rate structures for the purpose of sending appropriate price signals to heavier users (Staff Br. at 1).

Arizona Water opposes Staff's proposed rate design, and asserts that Staff did not evaluate the impact of the rate design on consumption (Kennedy Rb. 14-15). The Company protests that Staff's rate design shifts recovery of its revenue requirement into the third-tier commodity rate block, and that this will make it likely that the Company will be unable to earn its authorized rate of return (Co. Br. at 65-66). Arizona Water disagrees even more with RUCO's rate design because it applies the same breakover points to all meter sizes and would therefore have a greater impact on customers served by large meter sizes (Co. Br. at 69). The Company claims that Staff's proposed rate design would cause future water use to decrease in response to price increases (Kennedy Rb. at 17-19) based on the Company's study of the effects of imposition of a three-tier inverted block rate design in its

[15] An exception is the Ajo system, which requires a more substantial revenue increase due the increased costs of the Company's supply costs from Ajo Improvement Company ("AIC"), the source of the Company's water supply for the Ajo system.

[16] The one exception is in the White Tank system, which is receiving a revenue decrease. For White Tank system customers, rate increases will nonetheless appear on bills with usage between 20,000 and 25,000 gallons and on all bills with usage exceeding 25,000 gallons.

Eastern Group systems, which it believes demonstrated such an effect (Kennedy Rb. Exh. RJK-R4). We do not find Arizona Water's analysis of reduction in customer consumption in the Company's Eastern Group systems to be definitive. The proffered analysis does not appear to consider numerous factors in addition to rate design that may affect the specific water use of customers, including but not limited to precipitation levels and growth. Importantly, the Company did not claim, in connection with the presentation of its Eastern Group elasticity study, that the Eastern Group systems were not earning their authorized rate of return. Although the Company claims that inverted-block rates create revenue instability and will likely lead to under-collection of revenues, the effect on revenue collection in this case due to the implementation of the proposed rate design is not known and measurable, and we will therefore not adopt any "elasticity" adjustment to the revenue requirement we authorize herein. As is evidenced by the Company's plans to expand its water treatment infrastructure, much of the Western Group is poised for rapid growth (*see* Hammon Dt. at 4-5). We find that the risk of revenue instability the Company fears is sufficiently offset by the current growth in the Company's customer base to allow the implementation of a conservation-oriented rate design at this time. It is highly likely that new growth will be available to compensate for possible reductions in usage by existing customers, if demand proves to be elastic and existing customers respond to the conservation signals by reducing their usage in response to the new rate design. If, even with customer growth, Arizona Water finds it is not recovering its authorized revenue requirement, it is within the Company's control to file a rate case. After considering the evidence presented, we find that it is in the public interest for the Company to implement the conservation-oriented rate design proposed by Staff.

IX. OTHER ISSUES

A. Automatic Adjustment Mechanisms

Arizona Water is requesting authority to continue its existing purchased power and purchased

water adjustment mechanisms. RUCO, Casa Grande, and Staff recommend that the mechanisms be discontinued.

Staff states that adjustment mechanisms have traditionally been used to mitigate the regulatory lag for volatile, very large expense items, and are useful when a commodity constitutes a utility's single largest expense, such as for electric utilities where purchased gas or purchased power is the utility's single largest expense (Ludders at 7-8; Ludders Sb. at 6). Staff testified that Arizona Water's purchased pumping power and purchased water costs do not have these characteristics (Ludders Dt. at 7-9; Ludders Sb. at 6).

RUCO argues that the circumstances in this case parallel the circumstances in the Eastern Group Decision, in which the purchased water adjustment mechanisms for the Company's San Manuel and Superior systems were eliminated, and that the mechanisms should likewise be eliminated in this case (RUCO Br. at 15; Reply Br. at 8-9).

Casa Grande agrees with the Commission's reasoning in the Eastern Group Decision that adjustment mechanisms provide utilities with a disincentive to obtain the lowest possible cost commodity, because the costs are simply passed through to the ratepayers, and points to the fact that the Company has made no demonstrable effort to procure alternative, lower cost sources of power (*see* Tr. at 60, 628) as an illustration of the problem created by adjustors (City Br. at 16).

The Company asserts that there is a significant likelihood that the Company's cost for power provided by APS will increase in the near future, citing APS' recent application filed on July 22, 2005.[17] The Company argues that APS' recently approved Power Supply Adjustor makes the Company's costs for power at least as volatile as APS' cost of producing that power (Co. Br. at 27). We do not agree. APS' Power Supply Adjustor contains numerous complex safeguards designed to limit volatility to ratepayers (*see* Decision No. 67744 at 13-19). While we take notice of APS' July

[17] APS made a filing on July 22, 2005 in Docket No. E-01345A-05-0526 requesting recovery of unrecovered fuel and purchased power costs through the Power Supply Adjustor approved in Decision No. 67744 (April 7, 2005).

22, 2005 filing, the outcome of the filing is unknown. The effect it may have on Arizona Water's expenses, if any, is not known and measurable. The expenses we approve herein already include an adjustment for known and measurable post-test year changes in the Company's electricity costs (*see* Section V.B above).

The Company's Ajo system is the only Arizona Water system that retains a purchased water adjustment mechanism. The rates we approve herein also take into account a recent rate increase granted to AIC,[18] its water source supplier for the Ajo system (*see* Hubbard Dt. at 27-28). Arizona Water has already passed those increased costs on to its Ajo customers through the existing adjustment mechanism, and following this Decision, will recover those costs in base rates for the system, reducing the adjustor to a zero balance (*id.*). Prior to the 2004 AIC rate increase, Ajo system's water costs had not changed for 15 years (Tr. at 636). Arizona Water's witness Kennedy testified that AIC will likely raise its rates due to the necessity to treat for arsenic under the new EPA standard in the next couple of years (Tr. at 636-637). Rather than simply authorizing the Company to pass through as-yet unknown possible increased costs to ratepayers, we find it more reasonable to consider any increased costs due to AIC's arsenic remediation in Arizona Water's next rate case, when the magnitude of any increased costs will be known and measurable, and can be examined the context of the Company's other concurrent expenses, along with any possible cost-reducing alternatives.

There is a danger of piecemeal regulation inherent in adjustment mechanisms. Because they allow automatic increases in rates without a simultaneous review of a utility's unrelated costs, adjustment mechanisms have a built-in potential of allowing a utility to increase rates based on certain isolated costs when its other costs are declining, or when overall revenues are increasing faster than costs due to customer growth. Adjustment mechanisms should therefore be used only in

[18] Decision No. 67092 (June 29, 2004).

extraordinary circumstances to mitigate the effect of uncontrollable price volatility or uncertainty in the marketplace. We have evaluated the propriety of continuing the Company's existing purchased water and purchased power adjustment mechanisms in the Western Group based on all relevant factors, including the APS Power Supply Adjustor. The evidence presented in this case does not support a finding that the Company's power and water supply costs are subject to a degree of price volatility or uncertainty that justifies the existence of its adjustment mechanisms, and we will therefore order that they be discontinued.

B. Arsenic Cost Recovery Mechanism

The Company states in its application that under the new EPA rule reducing the maximum contaminant level ("MCL") for arsenic in drinking water from 50 parts per billion ("ppb") to 10 ppb, effective January, 2006, the Company must construct new arsenic treatment facilities for its Casa Grande, Stanfield, and White Tank systems (Kennedy Dt. at 10; Whitehead Dt. at 7-8; Hammon Dt. at 9). A Company-wide accounting order was approved in Docket No. W-01445-04-0473 for the deferral of operating and maintenance ("O&M") expenses for arsenic treatment. Arizona Water is requesting approval of an ACRM for its Western Group that is the same as the ACRM previously approved for the systems in its Northern and Eastern Groups. Arizona Water states that its proposed ACRM would allow the Company to recover capital costs and certain recoverable O&M costs directly related to the construction and continued operation of facilities required to comply with the new EPA MCL of 10 ppb for arsenic. In the application, Arizona Water estimates the total capital cost of the new facilities at $13.6 million, and estimates annual O&M expenses of $2.1 million. No party objected to the Company's request, which is reasonable and will be adopted.

C. Depreciation Rates

Staff recommends adoption in this case of the previously approved Company-wide depreciation schedule by National Association of Regulatory Utility Commissioners ("NARUC")

account that is presented on page 18 of the direct testimony of Arizona Water witness Ralph Kennedy in this proceeding (Hammon Dt. at 5). This recommendation is reasonable and will be adopted.

D. Non-Potable Water Tariff

Staff recommends that Arizona Water Company be required to file, within 60 days of this Decision, a new Non-Potable CAP Water tariff for its Casa Grande, Coolidge and White Tank systems which conforms to the new Apache Junction Non-Potable Central Arizona Project Water tariff approved in Decision No. 66849 (Hammon Dt. at 10-12). This recommendation is reasonable and will be adopted.

E. MAP Tariff

Staff recommends the continuation of the Company's Monitoring Assistance Program Surcharge ("MAP") surcharge, but recommends that the Company's MAP surcharge tariff, MA-262, be revised, Company-wide, to conform with the new ADEQ MAP fee structure, which is no longer based upon meter size. Staff further recommends that the Company be required to file as a compliance item in this matter, within 60 days of this Decision, but no later than the Company's annual surcharge calculation for each water system participating in the MAP, a revised MA-262 tariff for review and certification (Hammon Dt. at 5-6). This recommendation is reasonable and will be adopted.

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Having considered the entire record herein and being fully advised in the premises, the Commission finds, concludes, and orders that:

FINDINGS OF FACT

1. On September 8, 2004, Arizona Water filed an application with the Commission for a rate increase for the Company's Western Group systems, which include Ajo, Casa Grande, Coolidge, Stanfield, and White Tank.

2. Arizona Water operates a total of 18 water systems located in eight Arizona counties,

serving approximately 72,000 customers. The Western Group systems served 20,266 customers at December 31, 2003, the end of the test year.

3. The current rates and charges for the Western Group systems were authorized in Decision No. 58120 (December 23, 1992).

4. On September 24, 2004, Staff filed a Motion to Require Supplemental Sufficiency Information, or in the Alternative, to Suspend the Rate Case Timeclock ("Motion"). The Motion requested that the Company be required to submit an inverted tiered rate design as a condition of sufficiency under the rate case time-clock rule, or in the alternative, that the rate case time-clock be extended until such time that the Company filed an inverted block rate design. The Motion requested Oral Argument and expedited consideration.

5. On October 1, 2004, Arizona Water filed a Response opposing Staff's Motion.

6. On October 6, 2004, RUCO filed an Application to Intervene.

7. On October 8, 2004, Staff filed a Reply to the Company's Response.

8. Also on October 8, 2004, Staff filed a letter informing the Company that its application had not met the sufficiency requirements outlined in A.A.C. R14-2-103 because it did not contain the inverted tier rate design requested by Staff.

9. A telephonic Procedural Conference was held for discussion of procedural issues related to the Oral Argument requested by Staff. Arizona Water, RUCO and Staff attended.

10. On October 12, 2004, a Procedural Order was issued setting Oral Argument on the Motion.

11. On October 12, 2004, RUCO filed a Notice of Lodging RUCO's Response to the Motion.

12. On October 15, 2004, Oral Argument was held on Staff's Motion as scheduled. RUCO's intervention request was granted during the proceeding. After consideration of Staff's Motion, Arizona Water's Response, Staff's Reply, RUCO's Response, and the arguments of Staff, RUCO and Arizona Water on the issues raised in the Motion, the Motion was denied on the grounds that the Company had already provided a proposed rate design. The Company was ordered to respond on a timely basis to any data requests that Staff or RUCO served on the Company.

13. On October 18, 2004, Staff filed a letter notifying Arizona Water that its application met the sufficiency requirements set forth in A.A.C. R14-2-103, and classifying Arizona Water as a Class A utility.

14. On November 18, 2004, a Rate Case Procedural Order was issued setting this matter for hearing and setting associated procedural deadlines.

15. On February 3, 2005, Pivotal Group, Inc. filed a Motion to Intervene, which was granted by Procedural Order dated February 15, 2005.

16. On March 2, 2005, Arizona Water filed a Certificate of Notice certifying that the Company caused a copy of the form of public notice as required by the November 18, 2004 Procedural Order to be published in the *Coolidge Examiner* and *Casa Grande Dispatch* on January 26, 2005, and that the Company mailed a copy of the form of public notice to each of its customers beginning with the first billing cycle in February, 2005, with the mailing completed on February 28, 2005.

17. Public comment letters in opposition to the Company's proposed rate increase were filed on January 21, 2005, February 11, 2005, February 28, 2005, March 3, 2005, June 15, 2005, and July 29, 2005.

18. On March 15, 2005, Casa Grande filed an Application for Leave to Intervene, which was granted by Procedural Order issued April 1, 2005.

19. On May 19, 2005, Staff filed a Notice of Settlement Negotiation providing notice that Staff would be entering into settlement negotiations with the Company limited to the subject of how to deal with the Company's past, present and future costs associated with its CAP water allotments.

20. A Procedural Conference was held on June 6, 2005 at the request of Arizona Water. The Company, RUCO and Staff attended.

21. By Procedural Order issued June 7, 2005, the commencement date of the hearing was moved from June 16, 2005 to June 17, 2005. June 16, 2005 was held open for public comment, as it was the date noticed to the public and the Company's customers as the date for the hearing to commence. The date for the Pre-Hearing Conference was moved from June 10, 2005 to June 16, 2005, immediately following public comment.

22. On June 7, 2005, Casa Grande filed a Request for Reinstatement of Original Pre-Hearing Conference and One Day Continuation of Hearing Date.

23. On June 8, 2005, a Procedural Order was issued setting a Procedural Conference for June 10, 2005.

24. On June 10, 2005, a Procedural Conference was held as scheduled. Arizona Water, Casa Grande, RUCO and Staff attended and discussed procedural issues related to the hearing.

25. The Pre-Hearing Conference was held on June 16, 2005. There was an opportunity for public comment on that date. No members of the public appeared to provide comment on the application.

26. A hearing was held as scheduled commencing on June 17, 2005 and continuing on June 20, June 21, June 22, June 23, and June 24, 2005. No members of the public appeared to provide comment on the application.

27. Arizona Water, Casa Grande, RUCO and Staff filed closing briefs on August 1, 2005, and Reply Briefs on August 22, 2005.

28. Based on the adjusted test year data, as determined herein, the operating income under existing rates for the Western Group is $1,971,289.

29. Based on the adjusted test year data, as determined herein, the FVRB for the Western Group is $23,254,087. By system, the FVRB is as follows: Casa Grande, $17,495,567; Coolidge, $2,713,030; White Tank, $1,898,133; Ajo, $837,088; and Stanfield, $310,269.

30. A fair and reasonable rate of return on FVRB is 8.90 percent.

31. The revenue increase proposed by Arizona Water would produce an excessive return on FVRB.

32. The authorized increase in gross annual revenues for the Western Group is $160,510. By system, the authorized increase is as follows: Casa Grande, $89,542; Coolidge, $9,551; White Tank, ($4,323); Ajo, $61,365; and Stanfield, $4,375.

33. For the Casa Grande system, the rates set herein produce an increase in annual revenues of 1.13 percent which results in a monthly decrease from $25.50 to $25.06, or 1.7 percent ($0.44), for the average usage (10,709 gallons) 5/8 x 3/4-inch meter customer, and a monthly

decrease from $20.29 to $19.98, or 1.5 percent ($0.31), for the median usage (7,370 gallons) 5/8 x 3/4-inch meter customer. 5/8 x 3/4-inch meter customers with monthly usage of 15,000 gallons will experience a monthly decrease from $32.19 to $32.14, or 0.1 percent ($0.05). However, those 5/8 x 3/4-inch meter customers with monthly usage of 20,000 gallons will experience a monthly increase from $39.98 to $40.39, or 1.0 percent ($0.41).

34. For the Coolidge system, the rates set herein produce an increase in annual revenues of .67 percent, which results in a monthly decrease from $29.88 to $29.45, or 1.4 percent ($0.43), for the average usage (10,080 gallons) 5/8 x 3/4-inch meter customer and a monthly decrease from $24.07 to $23.99, or 0.3 percent ($0.08), for the median usage (7,307 gallons) 5/8 x 3/4-inch meter customer. However, 5/8 x 3/4-inch meter customers with monthly usage of 15,000 gallons will experience a 0.8 percent increase ($0.30) in their monthly bills, from $40.17 to $40.47, and those with monthly usage of 20,000 gallons will experience a 2.1 percent ($1.04) increase in their monthly bills, from $50.63 to $51.67.

35. For the White Tank system, the rates set herein produce a decrease in annual revenues of .55 percent which results in a decrease from $45.22 to $44.35, or 1.9 percent ($0.87), for the average usage (13,035 gallons) 5/8 x 3/4-inch meter customer, and a decrease from $34.68 to $33.64, or 3.0 percent ($1.04), for the median usage (8,684 gallons) 5/8 x 3/4-inch meter customer. However, 5/8 x 3/4-inch meter customers with monthly usage of 25,000 gallons will experience an increase in their bills from $74.23 to $74.93, or 0.9 percent ($0.70), and those with monthly usage of 50,000 gallons will experience an increase in their bills from $134.83 to $138.80, or 2.9 percent ($3.97).

36. For the Stanfield system, the rates set herein produce an increase in annual revenues of 3.34 percent which results in a decrease from $41.43 to $40.78, or 1.6 percent ($0.64) for the average usage (9,933 gallons) 5/8 x 3/4-inch meter customer, and a decrease from $34.15 to $33.81, or 1.0 percent ($0.35), for the median usage (7,521 gallons) 5/8 x 3/4-inch meter customer. However, 5/8 x 3/4-inch meter customers with monthly usage of 15,000 gallons will experience an increase in their bills from $56.70 to $58.97, or 4.0 percent ($2.27), and those with monthly usage of 20,000 gallons will experience an increase in their bills from $71.77 to $76.97, or 7.3 percent ($5.20).

37. For the Ajo system, the rates set herein produce an increase in annual revenues of 14.89 percent which results in an increase from $41.55 to $47.26, or 13.7 percent ($5.71), for the average usage (5,313 gallons) 5/8 x 3/4-inch meter customer and an increase from $33.67 to $39.31, or 16.8 percent ($5.64), for the median usage (3,868 gallons) 5/8 x 3/4-inch meter customer. 5/8 x 3/4-inch meter customers with monthly usage of 15,000 gallons will experience an 11.8 percent increase in their bills, from $94.40 to $105.54 ($11.14), and those with monthly usage of 20,000 will experience a 13.4 percent increase in their bills, from $121.68 to $138.04 ($16.33).

38. It is in the public interest to implement a rate design that promotes long-term conservation goals by sending appropriate price signals to heavier water users.

39. The Company's proposed single-tier rate design structure does not support our conservation goals.

40. The rate design approved herein addresses the goals of conservation, efficient water use, affordability, fairness, simplicity, and revenue stability, and is in the public interest.

41. The rates and charges for each system, as attached hereto in Exhibit G and incorporated by reference herein, are just and reasonable and shall be approved.

42. Arizona Water's proposed ACRM for the Western Group, which is based on the approved ACRM for its Northern Group and Eastern Group, is reasonable and should be approved.

43. Based on the evidence presented, circumstances do not exist in this case to justify the risks of piecemeal regulation inherent in other adjustment mechanisms, and Arizona Water's Western Group purchased power and purchased water adjustment mechanisms should be discontinued.

44. The conditions recommended by the Commission's Utilities Division Staff to be placed on the implementation of a Central Arizona Project Hook-Up Fee as they appear in Section II.A.6 of this Order, including the proposed requirements for a Central Arizona Project Water Use Plan, are reasonable and will be adopted, consistent with the discussion herein.

45. All of the Western Group water systems are within acceptable limits for non-account water. The Company audits and monitors monthly water sales, non-revenue water and water production, has a program of meter testing and replacement, and has state of the art leak detecting correlators and loggers (Hammon Dt. at 4).

46. The ADEQ has determined that the water systems in the Western Group are all delivering water that meets State and Federal drinking water quality standards required by the Arizona Administrative Code, Title 18, Chapter 4.

47. The Company's Casa Grande, Coolidge, and Stanfield systems are located in the Pinal Active Management Area ("AMA") as designated by the ADWR, and are in compliance with ADWR's monitoring and reporting requirements. Its White Tank system is located in the Phoenix AMA, and is in compliance with ADWR's monitoring and reporting requirements. Its Ajo system is not located in any AMA.

CONCLUSIONS OF LAW

1. Arizona Water Company is a public service corporation within the meaning of Article XV of the Arizona Constitution and A.R.S. Sections 40-250 and 40-241.

2. The Commission has jurisdiction over the Company and the subject matter of the application.

3. Notice of the application was provided in the manner prescribed by law.

4. It is reasonable to place conditions on the implementation of the Central Arizona Project Hook-Up Fee tariffs approved herein.

5. The rates and charges for each system, as attached hereto in Exhibit G and incorporated by reference herein, are just and reasonable and shall be approved.

ORDER

IT IS THEREFORE ORDERED that Arizona Water Company is hereby directed to file with the Commission on or before November 30, 2005, revised schedules of rates and charges consistent with Exhibit G and the discussion herein.

IT IS FURTHER ORDERED that the revised schedules of rates and charges shall be effective for all service rendered on and after December 1, 2005.

IT IS FURTHER ORDERED that Arizona Water Company's Western Group purchased power and purchased water adjustment mechanisms shall be discontinued effective December 1, 2005.

IT IS FURTHER ORDERED that Arizona Water Company shall notify its affected customers

of the revised schedules of rates and charges authorized herein by means of an insert in its next regularly scheduled billing in a form and manner acceptable to the Commission's Utilities Division Staff.

IT IS FURTHER ORDERED that the conditions recommended by the Commission's Utilities Division Staff as they appear in Section II.A.6 of this Order, including the proposed requirements for a Central Arizona Project Water Use Plan are hereby adopted.

IT IS FURTHER ORDERED that the Central Arizona Project Hook-Up Fee tariffs appearing in Exhibit A, Exhibit B and Exhibit C are hereby approved, subject to the conditions described in the previous Ordering Paragraph, including but not limited to the condition that the Central Arizona Project Hook-Up Fee will be reevaluated in Arizona Water Company's next rate case to determine if it should be continued, eliminated or modified based on Arizona Water Company's Central Arizona Project Water Use Plan and any other evidence introduced in that proceeding; and the condition that disapproval of the Central Arizona Project Water Use Plan shall result in a refund of collected Central Arizona Project Hook-Up Fee monies with 6 percent interest.

IT IS FURTHER ORDERED that Arizona Water Company shall file, on or before November 30, 2005, tariffs conforming to the Central Arizona Project Hook-Up Fee tariffs for its Casa Grande, Coolidge, and White Tank systems approved in the previous Ordering Paragraph.

IT IS FURTHER ORDERED that Arizona Water Company shall use monies collected pursuant to the Central Arizona Project Hook-Up Fee tariffs approved herein as non-operating revenues solely for the purpose of paying ongoing and deferred Central Arizona Project Municipal and Industrial capital charges incurred with regard to its Central Arizona Project allocations for each respective system.

IT IS FURTHER ORDERED that Arizona Water Company shall implement the Arsenic Cost Recovery Mechanism for the Western Group in accordance with the Arsenic Cost Recovery Mechanism approved in Decision No. 66400 for Arizona Water Company's Northern Group and Decision No. 66849 for Arizona Water Company's Eastern Group.

IT IS FURTHER ORDERED that Arizona Water Company shall file with the Commission's docket control as a compliance item in this matter, within 60 days of this Decision, a new Non-

Potable Central Arizona Project Water tariff for its Casa Grande, Coolidge and White Tanks systems that conforms to the new Apache Junction Non-Potable Central Arizona Project Water tariff approved in Decision No. 66849, for review and certification.

IT IS FURTHER ORDERED that Arizona Water Company shall file with the Commission's docket control as a compliance item in this matter, within 60 days of this Decision, but no later than the Company's annual surcharge calculation for each water system participating in the Arizona Department of Environmental Quality's Monitoring Assistance Program, a revised MA-262 tariff for review and certification.

IT IS FURTHER ORDERED that Arizona Water Company shall annually file as part of its annual report, an affidavit with the Utilities Division attesting that the Company is current in paying its property taxes in Arizona.

IT IS FURTHER ORDERED that Arizona Water Company shall use the depreciation rates that appear on the schedule presented on page 18 of the Direct Testimony of Arizona Water Company's witness Ralph Kennedy filed in this proceeding.

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IT IS FURTHER ORDERED that Arizona Water Company shall file a rate case application for its Western Group no later than September 30, 2007.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN | COMMISSIONER

COMMISSIONER | COMMISSIONER | COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Director of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 14th day of Nov., 2005.

BRIAN C. McNEIL
EXECUTIVE DIRECTOR

DISSENT _____

DISSENT _____

SERVICE LIST FOR: ARIZONA WATER COMPANY

DOCKET NO.: W-01445A-04-0650

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TARIFF SCHEDULE

UTILITY: Arizona Water Company
DOCKET NO.: W-01445A-04-0650

DECISION NO. _____
EFFECTIVE DATE: _____

CENTRAL ARIZONA PROJECT HOOK-UP FEE
for
CASA GRANDE SYSTEM

I. Purpose and Applicability

The purpose of the Central Arizona Project ("CAP") Water Hook-up Fee ("CAP Fee") payable to **Arizona Water Company** ("the Company") pursuant to this tariff is to equitably apportion the costs of CAP water. These charges are applicable to all new service connections established after the effective date of the tariff. The charges are one-time charges and are payable as a condition to the Company's establishment of service, as more particularly provided below.

II. Definitions

Unless the context otherwise requires, the definitions set forth in R-14-2-401 of the Arizona Corporation Commission's ("Commission") rules and regulations governing water utilities shall apply in interpreting, this tariff schedule.

"Applicant" means any party entering into an agreement with the Company for the installation of water facilities to serve new service connections.

"CAP costs" means Commission allowed on-going and deferred costs known as Municipal and Industrial capital charges incurred by the Company with regard to its CAP water allocations. These costs shall include allowance for funds used during construction which rate shall be the Company's annual cost of debt.

"Company" means Arizona Water Company, an Arizona corporation.

"Main Extension Agreement" means any agreement whereby an applicant agrees to advance the costs of the installation of water facilities to the Company to serve new service connections, or install water facilities to serve new service connections and transfer ownership of such water facilities to the Company, which agreement shall require the approval of the Commission's Utilities Division (same as line extension agreement).

"Service Connection" means and includes all service connections for residential, commercial, industrial, or other uses, regardless of meter size except for temporary services and separate fire protection services.

III. CAP Hook-up Fee Charges

Each new service connection shall pay the CAP Fee derived from the following table:

I Meter Size	II Fee
5/8" x ¾"	$208
3/4"	$208
1"	$208
1-1/2"	$733
2"	$1,173
3"	$2,347
4"	$3,667
6" or larger	$7,333

IV. Terms and Conditions

(A) Assessment of One Time CAP Fee: The CAP Fee may be assessed only once per service connection, or lot within a platted subdivision (similar to service line and meter installation charges). However, this provision does not exempt from the CAP Fee, any newly created parcel(s) which are the result of further subdivision of a lot or land parcel and which do not have a service connection.

(B) Use of CAP Fee: CAP Fees may only be used to pay for CAP costs as defined herein. CAP Fees shall not be used for expenses, maintenance, or operational purposes.

(C) Time of Payment:

(1) In the event that the Applicant is required to enter into a main extension agreement, whereby the Applicant agrees to advance the costs of installing mains to which new direct service connections will be made, valves, fittings, hydrants and other on-site improvements in order to extend service in accordance with R-14-2-406(B), payment of the charges required hereunder for those service connections shall be made by the Applicant within 15 calendar days after receipt of notification from the Company that the Utilities Division of the Commission has approved the main extension agreement in accordance with R-14-2-406(M).

(2) In the event the Applicant is not required to enter into a main extension agreement, the charges hereunder shall be due and payable at the time the service is initially established.

(D) Failure to Pay Charges, Delinquent Payments: Under no circumstances will the Company set a meter or otherwise allow service to be established if the Applicant has not paid in full all charges as provided by this CAP Fee tariff.

(E) CAP Fee Non-refundable: The amounts collected by the Company pursuant to this CAP Fee Tariff shall be non-refundable.

(F) Use of Charges Received: All funds collected by the Company as CAP Fees shall be used solely for the purpose of paying for CAP costs as defined herein.

(G) CAP Fee in Addition to Other Charges: The CAP Fee shall be in addition to any costs associated with a main extension agreement for on-site facilities, and are in addition to the amounts to be advanced pursuant to charges authorized under other sections of this tariff.

(H) Termination of CAP Fee: The CAP fee shall be terminated when all CAP costs (as defined herein) have been collected or when ordered by the Commission, whichever occurs first.

TARIFF SCHEDULE

UTILITY: Arizona Water Company
DOCKET NO.: W-01445A-04-0650

DECISION NO. _____
EFFECTIVE DATE: _____

CENTRAL ARIZONA PROJECT HOOK-UP FEE
for
COOLIDGE SYSTEM

I. Purpose and Applicability

The purpose of the Central Arizona Project ("CAP") Water Hook-up Fee ("CAP Fee") payable to **Arizona Water Company** ("the Company") pursuant to this tariff is to equitably apportion the costs of CAP water. These charges are applicable to all new service connections established after the effective date of the tariff. The charges are one-time charges and are payable as a condition to the Company's establishment of service, as more particularly provided below.

II. Definitions

Unless the context otherwise requires, the definitions set forth in R-14-2-401 of the Arizona Corporation Commission's ("Commission") rules and regulations governing water utilities shall apply in interpreting, this tariff schedule.

"Applicant" means any party entering into an agreement with the Company for the installation of water facilities to serve new service connections.

"CAP costs" means Commission allowed on-going and deferred costs known as Municipal and Industrial capital charges incurred by the Company with regard to its CAP water allocations. These costs shall include allowance for funds used during construction which rate shall be the Company's annual cost of debt.

"Company" means Arizona Water Company, an Arizona corporation.

"Main Extension Agreement" means any agreement whereby an applicant agrees to advance the costs of the installation of water facilities to the Company to serve new service connections, or install water facilities to serve new service connections and transfer ownership of such water facilities to the Company, which agreement shall require the approval of the Commission's Utilities Division (same as line extension agreement).

"Service Connection" means and includes all service connections for residential, commercial, industrial, or other uses, regardless of meter size except for temporary services and separate fire protection services.

III. CAP Hook-up Fee Charges

Each new service connection shall pay the CAP Fee derived from the following table:

III Meter Size	IV Fee
5/8" x 3/4"	$150
3/4"	$150
1"	$150
1-1/2"	$500
2"	$800
3"	$1,600
4"	$2,500
6" or larger	$5,000

IV. Terms and Conditions

(A) Assessment of One Time CAP Fee: The CAP Fee may be assessed only once per service connection, or lot within a platted subdivision (similar to service line and meter installation charges). However, this provision does not exempt from the CAP Fee, any newly created parcel(s) which are the result of further subdivision of a lot or land parcel and which do not have a service connection.

(B) Use of CAP Fee: CAP Fees may only be used to pay for CAP costs as defined herein. CAP Fees shall not be used for expenses, maintenance, or operational purposes.

(C) Time of Payment:

(1) In the event that the Applicant is required to enter into a main extension agreement, whereby the Applicant agrees to advance the costs of installing mains to which new direct service connections will be made, valves, fittings, hydrants and other on-site improvements in order to extend service in accordance with R-14-2-406(B), payment of the charges required hereunder for those service connections shall be made by the Applicant within 15 calendar days after receipt of notification from the Company that the Utilities Division of the Commission has approved the main extension agreement in accordance with R-14-2-406(M).

(2) In the event the Applicant is not required to enter into a main extension agreement, the charges hereunder shall be due and payable at the time the service is initially established.

(D) Failure to Pay Charges, Delinquent Payments: Under no circumstances will the Company set a meter or otherwise allow service to be established if the Applicant has not paid in full all charges as provided by this CAP Fee tariff.

(E) CAP Fee Non-refundable: The amounts collected by the Company pursuant to this CAP Fee Tariff shall be non-refundable.

(F) Use of Charges Received: All funds collected by the Company as CAP Fees shall be used solely for the purpose of paying for CAP costs as defined herein.

(G) CAP Fee in Addition to Other Charges: The CAP Fee shall be in addition to any costs associated with a main extension agreement for on-site facilities, and are in addition to the amounts to be advanced pursuant to charges authorized under other sections of this tariff.

(H) Termination of CAP Fee: The CAP fee shall be terminated when all CAP costs (as defined herein) have been collected or when ordered by the Commission, whichever occurs first.

TARIFF SCHEDULE

UTILITY: Arizona Water Company
DOCKET NO.: W-01445A-04-0650

DECISION NO. _____
EFFECTIVE DATE: _____

CENTRAL ARIZONA PROJECT HOOK-UP FEE
for
WHITE TANKS SYSTEM

I. Purpose and Applicability

The purpose of the Central Arizona Project ("CAP") Water Hook-up Fee ("CAP Fee") payable to **Arizona Water Company** ("the Company") pursuant to this tariff is to equitably apportion the costs of CAP water. These charges are applicable to all new service connections established after the effective date of the tariff. The charges are one-time charges and are payable as a condition to the Company's establishment of service, as more particularly provided below.

II. Definitions

Unless the context otherwise requires, the definitions set forth in R-14-2-401 of the Arizona Corporation Commission's ("Commission") rules and regulations governing water utilities shall apply in interpreting, this tariff schedule.

"Applicant" means any party entering into an agreement with the Company for the installation of water facilities to serve new service connections.

"CAP costs" means Commission allowed on-going and deferred costs known as Municipal and Industrial capital charges incurred by the Company with regard to its CAP water allocations. These costs shall include allowance for funds used during construction which rate shall be the Company's annual cost of debt.

"Company" means Arizona Water Company, an Arizona corporation.

"Main Extension Agreement" means any agreement whereby an applicant agrees to advance the costs of the installation of water facilities to the Company to serve new service connections, or install water facilities to serve new service connections and transfer ownership of such water facilities to the Company, which agreement shall require the approval of the Commission's Utilities Division (same as line extension agreement).

"Service Connection" means and includes all service connections for residential, commercial, industrial, or other uses, regardless of meter size except for temporary services and separate fire protection services.

III. CAP Hook-up Fee Charges

Each new service connection shall pay the CAP Fee derived from the following table:

V Meter Size	VI Fee
5/8" x 3/4"	$500
3/4"	$500
1"	$500
1-1/2"	$1,667
2"	$2,667
3"	$5,333
4"	$8,333
6" or larger	$16,667

IV. Terms and Conditions

(A) Assessment of One Time CAP Fee: The CAP Fee may be assessed only once per service connection, or lot within a platted subdivision (similar to service line and meter installation charges). However, this provision does not exempt from the CAP Fee, any newly created parcel(s) which are the result of further subdivision of a lot or land parcel and which do not have a service connection.

(B) Use of CAP Fee: CAP Fees may only be used to pay for CAP costs as defined herein. CAP Fees shall not be used for expenses, maintenance, or operational purposes.

(D) Time of Payment:

(1) In the event that the Applicant is required to enter into a main extension agreement, whereby the Applicant agrees to advance the costs of installing mains to which new direct service connections will be made, valves, fittings, hydrants and other on-site improvements in order to extend service in accordance with R-14-2-406(B), payment of the charges required hereunder for those service connections shall be made by the Applicant within 15 calendar days after receipt of notification from the Company that the Utilities Division of the Commission has approved the main extension agreement in accordance with R-14-2-406(M).

(2) In the event the Applicant is not required to enter into a main extension agreement, the charges hereunder shall be due and payable at the time the service is initially established.

(D) Failure to Pay Charges, Delinquent Payments: Under no circumstances will the Company set a meter or otherwise allow service to be established if the Applicant has not paid in full all charges as provided by this CAP Fee tariff.

(E) CAP Fee Non-refundable: The amounts collected by the Company pursuant to this CAP Fee Tariff shall be non-refundable.

(F) Use of Charges Received: All funds collected by the Company as CAP Fees shall be used solely for the purpose of paying for CAP costs as defined herein.

(G) CAP Fee in Addition to Other Charges: The CAP Fee shall be in addition to any costs associated with a main extension agreement for on-site facilities, and are in addition to the amounts to be advanced pursuant to charges authorized under other sections of this tariff.

(H) Termination of CAP Fee: The CAP fee shall be terminated when all CAP costs (as defined herein) have been collected or when ordered by the Commission, whichever occurs first.

ARIZONA WATER COMPANY
DOCKET NO. W-01445A-04-0650
CASA GRANDE SYSTEM

ALJ RECOMMENDED CAP M&I CHARGES RECOVERY (8,605 ACRE FEET)

Description:	Cost/AF	Customer Growth	$ Amount
M&I Balance as of 12/31/2003			3,382,907
2004 M&I charges on 8,605 AF	$30 (avg)		258,150
NP-260 Tariff M&I charges			-98,370
AFUDC estimate based on 2004 rate (5.211%)			192,492
Balance as of 12/31/2004			3,735,179
2005 M&I charges on 8,605 AF	$28/AF		240,940
NP-260 Tariff M&I charges			-63,812
AFUDC estimate based on 2004 rate			212,160
Balance as of 12/31/2005			4,124,467
2006 M&I charges on 8,605 AF	$24/AF		206,520
NP-260 Tariff M&I charges			-54,696
Hook-up fees collected ($208)		1,986	-413,088
AFUDC estimate based on 2004 rate			201,312
Balance as of 12/31/2006			4,064,515
2007 M&I charges on 8,605 AF	$21/AF		180,705
NP-260 Tariff M&I charges			-47,859
Hook-up fees collected ($208)		2,202	-458,016
AFUDC estimate based on 2004 rate			194,857
Balance as of 12/31/2007			3,934,202
2008 M&I charges on 8,605 AF	$21/AF		180,705
NP-260 Tariff M&I charges			-47,859
Hook-up fees collected ($208)		2,202	-458,016
AFUDC estimate based on 2004 rate			188,067
Balance as of 12/31/2008			3,797,098
2009 M&I charges on 8,605 AF	$21/AF		180,705
NP-260 Tariff M&I charges			-47,859
Hook-up fees collected ($208)		2,202	-458,016
AFUDC estimate based on 2004 rate			180,922
Balance as of 12/31/2009			3,652,851
2010 M&I charges on 8,605 AF	$21/AF		180,705
NP-260 Tariff M&I charges			-47,859
Hook-up fees collected ($208)		2,202	-458,016
AFUDC estimate based on 2004 rate			173,405
Balance as of 12/31/2010			3,501,086

ARIZONA WATER COMPANY
DOCKET NO. W-01445A-04-0650
CASA GRANDE SYSTEM

ALJ RECOMMENDED CAP M&I CHARGES RECOVERY (8,605 ACRE FEET)

Description:	Cost/AF	Customer Growth	$ Amount
2011 M&I charges on 8,605 AF	$21/AF		180,705
NP-260 Tariff M&I charges			-47,859
Hook-up fees collected ($208)		2,202	-458,016
AFUDC estimate based on 2004 rate			165,497
Balance as of 12/31/2011			3,341,413
2012 M&I charges on 8,605 AF	$21/AF		180,705
NP-260 Tariff M&I charges			-47,859
Hook-up fees collected ($208)		2,202	-458,016
AFUDC estimate based on 2004 rate			157,176
Balance as of 12/31/2012			3,173,419
2013 M&I charges on 8,605 AF	$21/AF		180,705
NP-260 Tariff M&I charges			-47,859
Hook-up fees collected ($208)		2,202	-458,016
AFUDC estimate based on 2004 rate			148,422
Balance as of 12/31/2013			2,996,672
2014 M&I charges on 8,605 AF	$21/AF		180,705
NP-260 Tariff M&I charges			-47,859
Hook-up fees collected ($208)		2,202	-458,016
AFUDC estimate based on 2004 rate			139,212
Balance as of 12/31/2014			2,810,714
2015 M&I charges on 8,605 AF	$21/AF		180,705
NP-260 Tariff M&I charges			-47,859
Hook-up fees collected ($208)		2,202	-458,016
AFUDC estimate based on 2004 rate			129,522
Balance as of 12/31/2015			2,615,065
2016 M&I charges on 8,605 AF	$21/AF		180,705
NP-260 Tariff M&I charges			-47,859
Hook-up fees collected ($208)		2,202	-458,016
AFUDC estimate based on 2004 rate			119,326
Balance as of 12/31/2016			2,409,222
2017 M&I charges on 8,605 AF	$21/AF		180,705
NP-260 Tariff M&I charges			-47,859
Hook-up fees collected ($208)		2,202	-458,016
AFUDC estimate based on 2004 rate			108,600
Balance as of 12/31/2017			2,192,652

ARIZONA WATER COMPANY
DOCKET NO. W-01445A-04-0650
CASA GRANDE SYSTEM

ALJ RECOMMENDED CAP M&I CHARGES RECOVERY (8,605 ACRE FEET)

Description:	Cost/AF	Customer Growth	$ Amount
2018 M&I charges on 8,605 AF	$21/AF		180,705
NP-260 Tariff M&I charges			-47,859
Hook-up fees collected ($208)		2,202	-458,016
AFUDC estimate based on 2004 rate			97,314
Balance as of 12/31/2018			1,964,796
2019 M&I charges on 8,605 AF	$21/AF		180,705
NP-260 Tariff M&I charges			-47,859
Hook-up fees collected ($208)		2,202	-458,016
AFUDC estimate based on 2004 rate			85,441
Balance as of 12/31/2019			1,725,067
2020 M&I charges on 8,605 AF	$21/AF		180,705
NP-260 Tariff M&I charges			-47,859
Hook-up fees collected ($208)		2,202	-458,016
AFUDC estimate based on 2004 rate			72,949
Balance as of 12/31/2020			1,472,846
2021 M&I charges on 8,605 AF	$21/AF		180,705
NP-260 Tariff M&I charges			-47,859
Hook-up fees collected ($208)		2,202	-458,016
AFUDC estimate based on 2004 rate			59,805
Balance as of 12/31/2021			1,207,481
2022 M&I charges on 8,605 AF	$21/AF		180,705
NP-260 Tariff M&I charges			-47,859
Hook-up fees collected ($208)		2,202	-458,016
AFUDC estimate based on 2004 rate			45,977
Balance as of 12/31/2022			928,288
2023 M&I charges on 8,605 AF	$21/AF		180,705
NP-260 Tariff M&I charges			-47,859
Hook-up fees collected ($208)		2,202	-458,016
AFUDC estimate based on 2004 rate			31,428
Balance as of 12/31/2023			634,547
2024 M&I charges on 8,605 AF	$21/AF		180,705
NP-260 Tariff M&I charges			-47,859
Hook-up fees collected ($208)		2,202	-458,016
AFUDC estimate based on 2004 rate			16,122
Balance as of 12/31/2024			325,498
2025 M&I charges on 8,605 AF	$21/AF		180,705
NP-260 Tariff M&I charges			-47,859
Hook-up fees collected ($208)		2,202	-458,016
AFUDC estimate based on 2004 rate			17
Balance as of 12/31/2025			346

ARIZONA WATER COMPANY
DOCKET NO. W-01445A-04-0650
COOLIDGE SYSTEM

STAFF RECOMMENDED CAP M&I CHARGES RECOVERY (2,000 ACRE FEET)

Description:	Cost/AF	Customer Growth	$ Amount
M&I Balance as of 12/31/2003			1,046,011
2004 M&I charges on 2,000 AF	$30 (avg)		60,000
NP-260 Tariff M&I charges			0
AFUDC estimate based on 2004 rate (5.211%)			57,634
Balance as of 12/31/2004			1,163,645
2005 M&I charges on 2,000 AF	$28/AF		56,000
NP-260 Tariff M&I charges			0
AFUDC estimate based on 2004 rate			63,556
Balance as of 12/31/2005			1,283,201
2006 M&I charges on 2,000 AF	$24/AF		48,000
NP-260 Tariff M&I charges			0
Hook-up fees collected ($150)		1,000	-150,000
AFUDC estimate based on 2004 rate			61,552
Balance as of 12/31/2006			1,242,753
2007 M&I charges on 2,000 AF	$21/AF		42,000
NP-260 Tariff M&I charges			0
Hook-up fees collected ($150)		1,000	-150,000
AFUDC estimate based on 2004 rate			59,132
Balance as of 12/31/2007			1,193,885
2008 M&I charges on 2,000 AF	$21/AF		42,000
NP-260 Tariff M&I charges			0
Hook-up fees collected ($150)		1,000	-150,000
AFUDC estimate based on 2004 rate			56,585
Balance as of 12/31/2008			1,142,471
2009 M&I charges on 2,000 AF	$21/AF		42,000
NP-260 Tariff M&I charges			0
Hook-up fees collected ($150)		1,000	-150,000
AFUDC estimate based on 2004 rate			53,906
Balance as of 12/31/2009			1,088,377
2010 M&I charges on 2,000 AF	$21/AF		42,000
NP-260 Tariff M&I charges			0
Hook-up fees collected ($150)		1,000	-150,000
AFUDC estimate based on 2004 rate			51,087
Balance as of 12/31/2010			1,031,465

ARIZONA WATER COMPANY
DOCKET NO. W-01445A-04-0650
COOLIDGE SYSTEM

STAFF RECOMMENDED CAP M&I CHARGES RECOVERY (2,000 ACRE FEET)

Description:	Cost/AF	Customer Growth	$ Amount
2011 M&I charges on 2,000 AF	$21/AF		42,000
NP-260 Tariff M&I charges			0
Hook-up fees collected ($150)		1,000	-150,000
AFUDC estimate based on 2004 rate			48,122
Balance as of 12/31/2011			971,586
2012 M&I charges on 2,000 AF	$21/AF		42,000
NP-260 Tariff M&I charges			0
Hook-up fees collected ($150)		1,000	-150,000
AFUDC estimate based on 2004 rate			45,001
Balance as of 12/31/2012			908,588
2013 M&I charges on 2,000 AF	$21/AF		42,000
NP-260 Tariff M&I charges			0
Hook-up fees collected ($150)		1,000	-150,000
AFUDC estimate based on 2004 rate			41,719
Balance as of 12/31/2013			842,306
2014 M&I charges on 2,000 AF	$21/AF		42,000
NP-260 Tariff M&I charges			0
Hook-up fees collected ($150)		1,000	-150,000
AFUDC estimate based on 2004 rate			38,265
Balance as of 12/31/2014			772,571
2015 M&I charges on 2,000 AF	$21/AF		42,000
NP-260 Tariff M&I charges			0
Hook-up fees collected ($150)		1,000	-150,000
AFUDC estimate based on 2004 rate			34,631
Balance as of 12/31/2015			699,202
2016 M&I charges on 2,000 AF	$21/AF		42,000
NP-260 Tariff M&I charges			0
Hook-up fees collected ($150)		1,000	-150,000
AFUDC estimate based on 2004 rate			30,808
Balance as of 12/31/2016			622,010
2017 M&I charges on 2,000 AF	$21/AF		42,000
NP-260 Tariff M&I charges			0
Hook-up fees collected ($150)		1,000	-150,000
AFUDC estimate based on 2004 rate			26,785
Balance as of 12/31/2017			540,795

ARIZONA WATER COMPANY
DOCKET NO. W-01445A-04-0650
COOLIDGE SYSTEM

STAFF RECOMMENDED CAP M&I CHARGES RECOVERY (2,000 ACRE FEET)

Description:	Cost/AF	Customer Growth	$ Amount
2018 M&I charges on 2,000 AF	$21/AF		42,000
NP-260 Tariff M&I charges			0
Hook-up fees collected ($150)		1,000	-150,000
AFUDC estimate based on 2004 rate			22,553
Balance as of 12/31/2018			455,347
2019 M&I charges on 2,000 AF	$21/AF		42,000
NP-260 Tariff M&I charges			0
Hook-up fees collected ($150)		1,000	-150,000
AFUDC estimate based on 2004 rate			18,100
Balance as of 12/31/2019			365,448
2020 M&I charges on 2,000 AF	$21/AF		42,000
NP-260 Tariff M&I charges			0
Hook-up fees collected ($150)		1,000	-150,000
AFUDC estimate based on 2004 rate			13,416
Balance as of 12/31/2020			270,863
2021 M&I charges on 2,000 AF	$21/AF		42,000
NP-260 Tariff M&I charges			0
Hook-up fees collected ($150)		1,000	-150,000
AFUDC estimate based on 2004 rate			8,487
Balance as of 12/31/2021			171,350
2022 M&I charges on 2,000 AF	$21/AF		42,000
NP-260 Tariff M&I charges			0
Hook-up fees collected ($150)		1,000	-150,000
AFUDC estimate based on 2004 rate			3,301
Balance as of 12/31/2022			66,651
2023 M&I charges on 2,000 AF	$21/AF		42,000
NP-260 Tariff M&I charges			0
Hook-up fees collected ($150)		1,000	-150,000
AFUDC estimate based on 2004 rate			-2,155
Balance as of 12/31/2023			-43,503
2024 M&I charges on 2000 AF	$21/AF		42,000
NP-260 Tariff M&I charges			0
Hook-up fees collected ($150)		1,000	-150,000
AFUDC estimate based on 2004 rate			-7,895
Balance as of 12/31/2024			-159,398
2025 M&I charges on 2000 AF	$21/AF		42,000
NP-260 Tariff M&I charges			0
Hook-up fees collected ($150)		1,000	-150,000
AFUDC estimate based on 2004 rate			-13,934
Balance as of 12/31/2025			-281,332

ARIZONA WATER COMPANY
DOCKET NO. W-01445A-04-0650
WHITE TANK SYSTEM

STAFF RECOMMENDED CAP M&I CHARGES RECOVERY (968 ACRE FEET)

Description:	Cost/AF	Customer Growth	$ Amount
M&I Balance as of 12/31/2003			506,268
2004 M&I charges on 968 AF	$30 (avg)		29,040
NP-260 Tariff M&I charges			0
AFUDC estimate based on 2004 rate (5.211%)			29,408
Balance as of 12/31/2004			564,716
2005 M&I charges on 968 AF	$28/AF		27,104
NP-260 Tariff M&I charges			0
AFUDC estimate based on 2004 rate			30,840
Balance as of 12/31/2005			622,660
2006 M&I charges on 968 AF	$24/AF		23,232
NP-260 Tariff M&I charges			0
Hook-up fees collected ($500)		141	-70,500
AFUDC estimate based on 2004 rate			29,984
Balance as of 12/31/2006			605,376
2007 M&I charges on 968 AF	$21/AF		20,328
NP-260 Tariff M&I charges			0
Hook-up fees collected ($500)		153	-76,500
AFUDC estimate based on 2004 rate			28,619
Balance as of 12/31/2007			577,823
2008 M&I charges on 968 AF	$21/AF		20,328
NP-260 Tariff M&I charges			0
Hook-up fees collected ($500)		153	-76,500
AFUDC estimate based on 2004 rate			27,183
Balance as of 12/31/2008			548,834
2009 M&I charges on 968 AF	$21/AF		20,328
NP-260 Tariff M&I charges			0
Hook-up fees collected ($500)		153	-76,500
AFUDC estimate based on 2004 rate			25,673
Balance as of 12/31/2009			518,335
2010 M&I charges on 968 AF	$21/AF		20,328
NP-260 Tariff M&I charges			0
Hook-up fees collected ($500)		153	-76,500
AFUDC estimate based on 2004 rate			24,083
Balance as of 12/31/2010			486,246

ARIZONA WATER COMPANY
DOCKET NO. W-01445A-04-0650
WHITE TANK SYSTEM

STAFF RECOMMENDED CAP M&I CHARGES RECOVERY (968 ACRE FEET)

Description:	Cost/AF	Customer Growth	$ Amount
2011 M&I charges on 968 AF	$21/AF		20,328
NP-260 Tariff M&I charges			0
Hook-up fees collected ($500)		153	-76,500
AFUDC estimate based on 2004 rate			22,411
Balance as of 12/31/2011			452,485
2012 M&I charges on 968 AF	$21/AF		20,328
NP-260 Tariff M&I charges			0
Hook-up fees collected ($500)		153	-76,500
AFUDC estimate based on 2004 rate			20,652
Balance as of 12/31/2012			416,965
2013 M&I charges on 968 AF	$21/AF		20,328
NP-260 Tariff M&I charges			0
Hook-up fees collected ($500)		153	-76,500
AFUDC estimate based on 2004 rate			18,801
Balance as of 12/31/2013			379,594
2014 M&I charges on 968 AF	$21/AF		20,328
NP-260 Tariff M&I charges			0
Hook-up fees collected ($500)		153	-76,500
AFUDC estimate based on 2004 rate			16,854
Balance as of 12/31/2014			340,275
2015 M&I charges on 968 AF	$21/AF		20,328
NP-260 Tariff M&I charges			0
Hook-up fees collected ($500)		153	-76,500
AFUDC estimate based on 2004 rate			14,805
Balance as of 12/31/2015			298,908
2016 M&I charges on 968 AF	$21/AF		20,328
NP-260 Tariff M&I charges			0
Hook-up fees collected ($500)		153	-76,500
AFUDC estimate based on 2004 rate			12,649
Balance as of 12/31/2016			255,385
2017 M&I charges on 968 AF	$21/AF		20,328
NP-260 Tariff M&I charges			0
Hook-up fees collected ($500)		153	-76,500
AFUDC estimate based on 2004 rate			10,381
Balance as of 12/31/2017			209,594

ARIZONA WATER COMPANY
DOCKET NO. W-01445A-04-0650
WHITE TANK SYSTEM

STAFF RECOMMENDED CAP M&I CHARGES RECOVERY (968 ACRE FEET)

Description:	Cost/AF	Customer Growth	$ Amount
2018 M&I charges on 968 AF	$21/AF		20,328
NP-260 Tariff M&I charges			0
Hook-up fees collected ($500)		153	-76,500
AFUDC estimate based on 2004 rate			7,995
Balance as of 12/31/2018			161,417
2019 M&I charges on 968 AF	$21/AF		20,328
NP-260 Tariff M&I charges			0
Hook-up fees collected ($500)		153	-76,500
AFUDC estimate based on 2004 rate			5,484
Balance as of 12/31/2019			110,729
2020 M&I charges on 968 AF	$21/AF		20,328
NP-260 Tariff M&I charges			0
Hook-up fees collected ($500)		153	-76,500
AFUDC estimate based on 2004 rate			2,843
Balance as of 12/31/2020			57,400
2021 M&I charges on 968 AF	$21/AF		20,328
NP-260 Tariff M&I charges			0
Hook-up fees collected ($500)		153	-76,500
AFUDC estimate based on 2004 rate			64
Balance as of 12/31/2021			1,292
2022 M&I charges on 968 AF	$21/AF		20,328
NP-260 Tariff M&I charges			0
Hook-up fees collected ($500)		153	-76,500
AFUDC estimate based on 2004 rate			-2,860
Balance as of 12/31/2022			-57,740
2023 M&I charges on 968 AF	$21/AF		20,328
NP-260 Tariff M&I charges			0
Hook-up fees collected ($500)		153	-76,500
AFUDC estimate based on 2004 rate			-5,936
Balance as of 12/31/2023			-119,848
2024 M&I charges on 968 AF	$21/AF		20,328
NP-260 Tariff M&I charges			0
Hook-up fees collected ($500)		153	-76,500
AFUDC estimate based on 2004 rate			-9,172
Balance as of 12/31/2024			-185,192
2025 M&I charges on 968 AF	$21/AF		20,328
NP-260 Tariff M&I charges			0
Hook-up fees collected ($500)		153	-76,500
AFUDC estimate based on 2004 rate			-12,577
Balance as of 12/31/2025			-253,942

CASA GRANDE

MONTHLY USAGE CHARGE:

5/8" x ¾" Meter	$ 10.48
1" Meter	25.20
2" Meter	63.10
3" Meter	105.15
4" Meter	210.25
6" Meter	367.90
8" Meter	367.90
10" Meter	1,205.20

Note: Currently there are no customers on 10" meters

Gallons included in minimum	0

Commodity Rates

5/8 x 3/4-Inch Meter	
0 to 3,000 Gallons	$ 1.00
3,001 to 10,000 Gallons	1.4869
10,001 Gallons and over	1.65
1-Inch Meter	
0 to 67,000 Gallons	1.4869
67,001 Gallons and over	1.65
2-Inch Meter	
0 to 296,000 Gallons	1.4869
296,001 Gallons and over	1.65
3-Inch Meter	
0 to 552,000 Gallons	1.4869
552,001 Gallons and over	1.65
4-Inch Meter	
0 to 1,195,000 Gallons	1.4869
1,195,001 Gallons and over	1.65
6- and 8-Inch Meters	
0 to 2,160,000 Gallons	1.4869
2,160,001 Gallons and over	1.65
10-Inch Meter	
0 to 7,292,000 Gallons	1.4869

7,292,001 Gallons and over	1.65

Service Line and Meter Installation Charges
(Refundable pursuant to A.A.C. R14-2-205)

5/8" x ¾" Meter	(a)
1" Meter	(a)
2" Meter	(b)
3" Meter	(b)
4" Meter	(b)
6" Meter	(b)
8" Meter	(b)
10" Meter	(b)

Service Charges

Establishment	16.00
Guarantee Deposit	(c)
Reconnection for Delinquency (per disconnection)	16.00
Re-establishment	(d)
Service Call Out (After Regular Working Hours Only)	35.00
Returned Check Charge	25.00
Meter Reread (After Regular Working Hours Only)	35.00
Meter Test	50.00
Late Charge	(e)

(a) No charge for 5/8" x 3/4" and 1" if on existing pipelines. Full cost for 5/8" x 3/4" and 1" if on new pipelines.

(b) Full cost for 2" and larger if on existing or new pipelines.

(c) Per Commission Rule A.A.C. R14-2-403(B).

(d) Eight times the customer's monthly minimum charge, or payment of the monthly minimum charges since disconnection, whichever is less.

(e) 1.50 percent after 15 days.

COOLIDGE

MONTHLY USAGE CHARGE:

5/8" x ¾" Meter	$ 10.90
1" Meter	27.25
2" Meter	87.20
3" Meter	174.40
4" Meter	272.50
6" Meter	545.00
8" Meter	872.00
10" Meter	1,253.50

Note: Currently there are no customers on either 8" or 10" meters

Gallons included in minimum	0

Commodity Rates

5/8 x 3/4-Inch Meter	
0 to 3,000 Gallons	$ 1.55
3,001 to 10,000 Gallons	1.96
10,001 Gallons and over	2.24
1-Inch Meter	
0 to 47,000 Gallons	1.96
47,001 Gallons and over	2.24
2-Inch Meter	
0 to 258,000 Gallons	1.96
258,001 Gallons and over	2.24
3-Inch Meter	
0 to 568,000 Gallons	1.96
568,001 Gallons and over	2.24
4-Inch Meter	
0 to 917,000 Gallons	1.96
917,001 Gallons and over	2.24
6-Inch Meter	
0 to 1,889,000 Gallons	1.96
1,889,001 Gallons and over	2.24
8-Inch Meter	
0 to 3,055,000 Gallons	1.96
3,055,001 Gallons and over	2.24

10-Inch Meter	
0 to 4,416,000 Gallons	1.96
4,416,001 Gallons and over	2.24

Service Line and Meter Installation Charges
(Refundable pursuant to A.A.C. R14-2-205)

5/8" x ¾" Meter	(a)
1" Meter	(a)
2" Meter	(b)
3" Meter	(b)
4" Meter	(b)
6" Meter	(b)
8" Meter	(b)
10" Meter	(b)

Service Charges

Establishment	16.00
Guarantee Deposit	(c)
Reconnection for Delinquency (per disconnection)	16.00
Reestablishment	(d)
Service Call Out (After Regular Working Hours Only)	35.00
Returned Check Charge	25.00
Meter Reread (After Regular Working Hours Only)	35.00
Meter Test	50.00
Late Charge	(e)

(a) No charge for 5/8" x 3/4" and 1" if on existing pipelines. Full cost for 5/8" x 3/4" and 1" if on new pipelines.

(b) Full cost for 2" and larger if on existing or new pipelines.

(c) Per Commission Rule A.A.C. R14-2-403(B).

(d) Eight times the customer's monthly minimum charge, or payment of the monthly minimum charges since disconnection, whichever is less.

(e) 1.50 percent after 15 days.

WHITE TANK

MONTHLY USAGE CHARGE:

5/8" x ¾" Meter	$ 16.05
1" Meter	31.10
2" Meter	82.85
3" Meter	155.40
4" Meter	401.25
6" Meter	802.50
8" Meter	1,284.00
10" Meter	1,845.75

Note: Currently there are no customers on any meters larger than 3"

Gallons included in minimum	0

Commodity Rates

5/8 x 3/4-Inch Meter	
0 to 3,000 Gallons	$ 1.60
3,001 to 10,000 Gallons	2.25
10,001 Gallons and over	2.55
1-Inch Meter	
0 to 30,000 Gallons	2.25
30,001 Gallons and over	2.55
2-Inch Meter	
0 to 183,000 Gallons	2.25
183,001 Gallons and over	2.55
3-Inch Meter	
0 to 401,000 Gallons	2.25
401,001 Gallons and over	2.55
4-Inch Meter	
0 to 1,145,000 Gallons	2.25
1,145,001 Gallons and over	2.55
6-Inch Meter	
0 to 2,359,000 Gallons	2.25
2,359,001 Gallons and over	2.55
8-Inch Meter	
0 to 3,817,000 Gallons	2.25
3,817,001 Gallons and over	2.55

10-Inch Meter	
0 to 5,518,000 Gallons	2.25
5,518,001 Gallons and over	2.55

Service Line and Meter Installation Charges
(Refundable pursuant to A.A.C. R14-2-205)

5/8" x ¾" Meter	(a)
1" Meter	(a)
2" Meter	(b)
3" Meter	(b)
4" Meter	(b)
6" Meter	(b)
8" Meter	(b)
10" Meter	(b)

Service Charges

Establishment	16.00
Guarantee Deposit	(c)
Reconnection for Delinquency (per disconnection)	16.00
Reestablishment	(d)
Service Call Out (After Regular Working Hours Only)	35.00
Returned Check Charge	25.00
Meter Reread (After Regular Working Hours Only)	35.00
Meter Test	50.00
Late Charge	(e)

(a) No charge for 5/8" x 3/4" and 1" if on existing pipelines. Full cost for 5/8" x 3/4" and 1" if on new pipelines.

(b) Full cost for 2" and larger if on existing or new pipelines.

(c) Per Commission Rule A.A.C. R14-2-403(B).

(d) Eight times the customer's monthly minimum charge, or payment of the monthly minimum charges since disconnection, whichever is less.

(e) 1.50 percent after 15 days.

STANFIELD

MONTHLY USAGE CHARGE:

5/8" x ¾" Meter	$ 14.65
1" Meter	36.63
2" Meter	117.20
3" Meter	234.40
4" Meter	366.25
6" Meter	732.50
8" Meter	1,172.00
10" Meter	1,684.75

Note: Currently there are no customers on any meters larger than 2"

Gallons included in minimum	0

Commodity Rates

5/8 x 3/4-Inch Meter	
0 to 3,000 Gallons	$ 2.03
3,001 to 10,000 Gallons	2.89
10,001 Gallons and over	3.60
1-Inch Meter	
0 to 29,000 Gallons	2.89
29,001 Gallons and over	3.60
2-Inch Meter	
0 to 139,000 Gallons	2.89
139,001 Gallons and over	3.60
3-Inch Meter	
0 to 303,000 Gallons	2.89
303,001 Gallons and over	3.60
4-Inch Meter	
0 to 487,000 Gallons	2.89
487,001 Gallons and over	3.60
6-Inch Meter	
0 to 1,002,000 Gallons	2.89
1,002,001 Gallons and over	3.60
8-Inch Meter	
0 to 1,620,000 Gallons	2.89
1,620,001 Gallons and over	3.60

10-Inch Meter	
0 to 2,341,000 Gallons	2.89
2,341,001 Gallons and over	3.60

Service Line and Meter Installation Charges
(Refundable pursuant to A.A.C. R14-2-205)

5/8" x ¾" Meter	(a)
1" Meter	(a)
2" Meter	(b)
3" Meter	(b)
4" Meter	(b)
6" Meter	(b)
8" Meter	(b)
10" Meter	(b)

Service Charges

Establishment	16.00
Guarantee Deposit	(c)
Reconnection for Delinquency (per disconnection)	16.00
Reestablishment	(d)
Service Call Out (After Regular Working Hours Only	35.00
Returned Check Charge	25.00
Meter Reread (After Regular Working Hours Only)	35.00
Meter Test	50.00
Late Charge	(e)

(a) No charge for 5/8" x 3/4" and 1" if on existing pipelines. Full cost for 5/8" x 3/4" and 1" if on new pipelines.

(b) Full cost for 2" and larger if on existing or new pipelines.

(c) Per Commission Rule A.A.C. R14-2-403(B).

(d) Eight times the customer's monthly minimum charge, or payment of the monthly minimum charges since disconnection, whichever is less.

(e) 1.50 percent after 15 days.

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MONTHLY USAGE CHARGE:

5/8" x ¾" Meter	$ 21.04
1" Meter	52.10
2" Meter	170.00
3" Meter	336.34
4" Meter	526.00
6" Meter	1,052.00
8" Meter	1,683.20
10" Meter	2,419.60

Note: Currently there are no customers on any meter larger than 2"

Gallons included in minimum 0

Commodity Rates

5/8 x 3/4-Inch Meter	
0 to 3,000 Gallons	$ 4.50
3,001 to 10,000 Gallons	5.50
10,001 Gallons and over	6.50
1- and 2-Inch Meters	
0 to 25,000 Gallons	5.50
25,001 Gallons and over	6.50
3-Inch Meter	
0 to 165,000 Gallons	5.50
165,001 Gallons and over	6.50
4-Inch Meter	
0 to 325,000 Gallons	5.50
325,001 Gallons and over	6.50
6-Inch Meter	
0 to 775,000 Gallons	5.50
775,001 Gallons and over	6.50
8-Inch Meter	
0 to 1,310,000	5.50
1,310,001 Gallons and over	6.50
10 Inch Meter	
0 to 1,940,000 Gallons	5.50
1,940,001 Gallons and over	6.50

Service Line and Meter Installation Charges
(Refundable pursuant to A.A.C. R14-2-205)

5/8" x ¾" Meter	(a)
1" Meter	(a)
2" Meter	(b)
3" Meter	(b)
4" Meter	(b)
6" Meter	(b)
8" Meter	(b)
10" Meter	(b)

Service Charges

Establishment	16.00
Guarantee Deposit	(c)
Reconnection for Delinquency (per disconnection)	16.00
Reestablishment	(d)
Service Call Out (After Regular Working Hours Only	35.00
Returned Check Charge	25.00
Meter Reread (After Regular Working Hours Only)	35.00
Meter Test	50.00
Late Charge	(e)

(a) No charge for 5/8" x 3/4" and 1" if on existing pipelines. Full cost for 5/8" x 3/4" and 1" if on new pipelines.

(b) Full cost for 2" and larger if on existing or new pipelines.

(c) Per Commission Rule A.A.C. R14-2-403(B).

(d) Eight times the customer's monthly minimum charge, or payment of the monthly minimum charges since disconnection, whichever is less.

(e) 1.50 percent after 15 days.